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PROPOSAL

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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
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Subject:	Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds

Delegations will find attached document COM(2018) 93 final.

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Brussels, 12.3.2018
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2018/0042 (COD)

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

**on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered
bonds**

(Text with EEA relevance)

{SWD(2018) 50 final} - {SWD(2018) 51 final}

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE PROPOSAL

• Reasons for and objectives of the proposal

The Commission has today adopted a package of measures to deepen the Capital Markets Union together with the Communication "Completing Capital Markets Union by 2019 – time to accelerate delivery". The package includes this proposal, as well as a proposal for an enabling EU framework on covered bonds, a proposal to facilitate the cross-border distribution of investment funds, a proposal for an enabling framework on European crowdfunding service providers (ECSP) for business, as well as a proposal on the law applicable to the third-party effects of assignments of claims and a Communication on the applicable law to the proprietary effects of transactions in securities.

Covered bonds are debt obligations issued by credit institutions and secured against a ring-fenced pool of assets to which bondholders have direct recourse as preferred creditors. At the same time, bondholders remain entitled to claim against the issuing entity as ordinary creditors. This double claim against the cover pool and the issuer is referred to as the 'dual recourse' mechanism.

Covered bonds are issued by credit institutions and are as such an important and efficient source of funding for European banks. They facilitate the financing of mortgage and public sector loans, thereby supporting lending more broadly. A significant advantage of covered bonds compared with other kinds of bank funding sources such as asset-backed securities is the fact that banks retain the risk on their balance sheets and investors have claims directly with the bank. Therefore, covered bonds allow banks to lend not only more, but also more safely. Not least for that reason, covered bonds fared well during the financial crisis compared with other funding instruments. They proved to be a reliable and stable funding source for European banks at a time when other funding channels were drying up.

An enabling framework for covered bonds at EU level would enhance their use as a stable and cost-effective source of funding for credit institutions, especially where markets are less developed, in order to help finance the real economy in line with the objectives of the Capital Markets Union (CMU). The enabling framework would also provide investors with a wider and safer range of investment opportunities and would help preserve financial stability. Member States will have to transpose these rules, ensuring that national covered bond frameworks comply with the principles-based requirements set out in this proposal. All covered bonds across Europe will therefore have to respect the minimum harmonisation requirements as set out in this proposal.

The enabling framework for covered bonds is featured in the Commission Work Programme for 2018¹. In the letter of intent following up his latest State of the Union speech, the President of the European Commission confirmed that an enabling framework for covered bonds should be launched or completed by end-2018 to ensure a deeper and fairer internal market.² The Commission confirmed this intention in the Mid-Term Review of the CMU Action Plan of June 2017³.

¹ COM(2017) 650.

² European Commission (2017). "State of the Union 2017: Letter of intent to President Antonio Tajani and to Prime Minister Jüri Ratas".

³ COM(2017) 292.

The development of covered bonds across the single market is uneven; they are very important in some Member States, less so in others. Furthermore, they are only partially addressed in Union law. While they benefit from preferential prudential and regulatory treatment in various respects in the light of the lower risks (e.g. banks investing in them do not have to set aside as much regulatory capital as when they invest in other assets), Union law does not comprehensively address what actually constitutes a covered bond. Rather, preferential treatments are granted to covered bonds as defined in Directive 2009/65/EC⁴. However, that definition was drafted with a specific purpose in mind – limiting what undertakings for collective investment in transferable securities (UCITS) could invest in – and is not fit for the broader policy objectives of the CMU.

A Union legislative framework on covered bonds should expand the capacity of credit institutions to provide financing to the real economy and contribute to the development of covered bonds across the Union, particularly in Member States where no market for them currently exists.

The framework would also increase cross-border flows of capital and investment. It would thus contribute to the CMU and in particular to the further leveraging of credit institutions' capacity to support the wider economy. In particular, it would ensure that banks have a broad range of safe and efficient funding tools at their disposal.

The framework consists of a Directive and a Regulation – the two instruments should be seen as a single package.

This proposed Regulation will mainly amend Article 129 of Regulation (EU) No 575/2013 (Capital Requirements Regulation (CRR)). The amendments build on the current prudential treatment but add requirements on minimum overcollateralisation and substitution assets. They would strengthen the requirements for covered bonds being granted preferential capital treatment.

The proposed Directive will specify the core elements of covered bonds and provide a common definition as a consistent and sufficiently detailed point of reference for prudential regulation purposes, applicable across financial sectors. It will establish the structural features of the instrument, a covered bond specific public supervision, rules allowing use of the 'European Covered Bonds' label and competent authorities' publication obligations in the field of covered bonds.

- **Consistency with existing policy provisions in the policy area**

The proposal is part of ongoing work to ensure that covered bonds are of sufficient quality to justify their continuing preferential treatment.

It builds on ongoing work by the European Banking Authority (EBA) to identify best practices as regards the issuance of covered bonds⁵. That work is a response to the European

⁴ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

⁵ *Report on EU covered bond frameworks and capital treatment*, EBA (2014); *Report on covered bonds — recommendations on harmonisation of covered bond frameworks in the EU*, EBA (2016), EBA-Op-2016-23.

Systemic Risk Board (ESRB) recommendation that best practices be identified and monitored so as to ensure robust and consistent frameworks for covered bonds across the Union⁶.

The proposal amends existing legislation, as recommended by the EBA, and renders it fully consistent with policy provisions in the field of prudential requirements for institutions investing in covered bonds.

- **Consistency with other Union policies**

One of the Commission's most important objectives is to stimulate investment and create jobs. The Commission has launched a number of initiatives to ensure that the financial system contributes fully in that respect. First among those is the CMU, which involves a series of initiatives to unlock funding for Europe's growth. Covered bonds should be seen in the context of the CMU, as bank financing is currently by far the most important funding channel in Europe and one of the CMU actions is to leverage banking capacity further in support of the wider economy. Covered bonds represent an efficient and stable funding tool for European banks. A legislative framework to harmonise covered bonds should be seen in this broader policy context.

Another important Commission objective in the realm of financial markets is to ensure that capital requirements for banks reflect the risks attached to the assets in their balance sheets. Accordingly, the CRR requirements ensure that covered bonds granted the most preferential treatment have a uniformly high level of investor protection. However, because Union law does not comprehensively address what actually constitutes a covered bond (see above), harmonisation is needed to ensure that covered bonds have similar structural characteristics across the Union that make them coherent with the relevant prudential requirements. The harmonisation of covered bonds is therefore in line with the Commission's aim of financial stability, as pursued in its regulation of financial markets.

2. LEGAL BASIS, SUBSIDIARITY AND PROPORTIONALITY

- **Legal basis**

The proposed amendment is based on Article 114 of the Treaty on the Functioning of the European Union, i.e. the same legal basis as the act that is being amended.

- **Subsidiarity (for non-exclusive competence)**

As Union legislation grants preferential capital treatment to covered bonds, the related requirements have to be amended at Union level. Furthermore, it is considered necessary to handle the requirements for preferential capital treatment at Union level to ensure a consistent degree of investor protection and a level playing-field for European credit institutions.

- **Proportionality**

The proposal strikes a balance between ensuring a sufficiently robust framework for covered bonds granted preferential treatment and avoiding a disproportionate increase in the cost of issuance. In seeking the right balance, the Commission considered all the associated costs and potential benefits (see accompanying impact assessment). The proposal builds on the recommendations from the EBA 2016 Report, but allows for some limited deviations (i.e. some provisions are less detailed than foreseen in the EBA report). This is to leave more room

⁶ Recommendation of 20 December 2012 on the funding of credit institutions, European Systemic Risk Board (ESRB/2012/2) (2013/C 119/01).

for protecting the existing well-functioning national systems as strongly suggested by the stakeholders during the consultations and reinforces the proportionality of the proposal. The deviations do not involve the core structural features of covered bonds and their supervision.

The proposal includes provisions on the grandfathering of existing covered bonds in order to smooth costs for their issuers and for markets. As the impact assessment shows, expected costs can be deemed proportionate in relation to expected benefits.

- **Choice of the instrument**

A regulation is the appropriate instrument, as the provisions replace those in Regulation (EU) No 575/2013 concerning covered bonds' eligibility for preferential capital treatment. This achieves the same direct legal effect as the current Regulation, ensuring that the objectives of the proposal are achieved consistently across the Union and contributing to greater certainty and a level playing-field for issuers and investors.

3. RESULTS OF EX-POST EVALUATIONS, STAKEHOLDER CONSULTATIONS AND IMPACT ASSESSMENTS

- **Ex-post evaluations/fitness checks of existing legislation**

This initiative on covered bonds relates to an area, which is very largely not addressed by Union legislation currently.

- **Stakeholder consultations**

The Commission consulted stakeholders at several points in the preparation of this proposal, in particular by means of:

- i) an open public consultation on covered bonds (September 2015 to 6 January 2016);
- ii) publication of an inception impact assessment (9 June 2017);
- iii) two meetings of the Expert Group on Banking, Payments and Insurance (EGBPI) and one meeting of the Financial Services Committee (FSC).

Under the CMU action plan, the purpose of the public consultation was to evaluate weaknesses and vulnerabilities in national covered bond markets and to assess the merits of a European framework. While respondents were concerned that harmonisation based on a 'one size fits all' approach could impair well-functioning markets and reduce flexibility and the range of products on offer, they also expressed cautious support for targeted EU action, provided that harmonisation is principles-based, builds on existing frameworks and takes account of the specificities of national markets. The results of the consultation were discussed at a public hearing on 1 February 2016⁷.

The Commission received four responses on the inception impact assessment, all of which supported the EU legislative initiative. The respondents addressed specific aspects of national frameworks (e.g. liquidity) and confirmed the general view in favour of harmonisation while not jeopardising well-functioning national systems.

At the first EGBPI meeting (9 June 2017), the majority of Member States expressed support for a Union covered bond framework based on the EBA's 2016 advice, provided it remains principles-based. At the second meeting (28 September 2017), the discussion was more

⁷ The results of the public consultation can be found here: http://ec.europa.eu/finance/consultations/2015/covered-bonds/index_en.htm

detailed, but in general Member States still supported a principles-based approach. Member States expressed similar views at the FSC meeting in July 2017.

The proposal also builds on further meetings with stakeholders and EU institutions. In general (while tending to focus on the aspect most relevant for their situation), stakeholders concentrated on balancing the need to change the existing framework so as to address prudential concerns with the wish to avoid disrupting well-functioning national systems. Input focusing on prudential concerns relating to the preferential treatment of covered bonds came mainly from the ESRB, the EBA and the European Central Bank, and to some extent from the competent authorities in the Member States with well-developed covered bond markets and from rating agencies, while the focus on well-functioning national markets came mainly from Member States with well-developed covered bond markets, from issuers and from investors.

The European Parliament has also expressed support for action, calling for a European legislative framework on covered bonds⁸.

- **Collection and use of expertise**

On 1 July 2014, the EBA issued a report identifying best practices with a view to ensuring robust and consistent frameworks for covered bonds across the Union⁹. The report was in response to a December 2012 ESRB recommendation on the funding of credit institutions¹⁰. It also set out the EBA's opinion on the adequacy of the current prudential treatment of covered bonds, following the Commission's call for advice in December 2013 on the basis of Article 503 CRR¹¹.

As a follow-up, the ESRB recommended that the EBA monitor the functioning of the covered bonds market by reference to the best practices it had identified and called on the EBA to recommend further action if necessary.

In response, the EBA issued a *Report on covered bonds — recommendations on the harmonisation of covered bond frameworks in the EU* in December 2016. This includes a comprehensive analysis of regulatory developments in covered bond frameworks in individual Member States, with a particular focus on the level of alignment with the best practices identified in the previous report. Building on the results of the analysis, the EBA called for legislative action to harmonise covered bonds at Union level.

This proposal builds on the EBA's analysis and advice. It deviates only in minor areas, e.g. as regards the level of detail concerning derivatives belonging to the cover pool; in the cover pool monitor not being mandatory; and, in the level of overcollateralisation.

In August 2016, the Commission had commissioned a study from ICF¹² to assess the performance of current covered bond markets and the costs and benefits of potential EU action. The study, which was published in May 2017, looked at the potential benefits and costs of the EBA's recommendations. Overall, it concluded that the potential benefits of a

⁸ Resolution of 4 July 2017 on the report *Towards a pan-European covered bonds framework* (2017/2005(INI)).

⁹ *Report on EU covered bond frameworks and capital treatment*, EBA (2014).

¹⁰ Recommendation of 20 December 2012 on funding of credit institutions, European Systemic Risk Board (ESRB/2012/2) (2013/C 119/01).

¹¹ Call to EBA for advice on covered bonds capital requirements, ref. Ares(2013) 3780921 (20.12.2013).

¹² *Covered bonds in the European Union: harmonisation of legal frameworks and market behaviours*, ICF (2017).

legislative initiative outweighed the potential costs and there was therefore a case for legislative action.

In December 2017, the Basel Committee on Banking Supervision (BCBS) finalised the outstanding post-crisis regulatory reforms of the Basel III international regulatory framework for banks¹³. As part of the reforms, the BCBS revised the standardised approach on credit risk by including, *inter alia*, new standards on exposures to covered bonds. For the first time, the new standards largely replicate at international level the EU's approach in the CRR, allowing covered bond exposures to benefit from lower risk weights subject to certain conditions. It is thus recognised that the EU's treatment of covered bonds is prudentially viable and justified by the underlying characteristics of the instrument.

- **Impact assessment**

This proposal is accompanied by an impact assessment, which was submitted to the Regulatory Scrutiny Board (RSB) on 6 October 2017 and approved on 17 November 2017¹⁴.

The RSB commended the comprehensive and well-structured nature of the impact assessment and acknowledged that it applies its intervention logic systematically and contains a high degree of quantification to substantiate its findings. The RSB recommended that the report be improved in some limited respects:

- a) the reasons for considering a '29th regime' unattractive; and
- b) greater clarity on the main elements of the 'minimum harmonisation' approach, and whether (and how) they deviate from the EBA advice (Annex 6 has been added for this purpose).

The impact assessment has been amended accordingly, also addressing additional suggestions of the RSB:

- i) a more detailed explanation concerning the European secured note (ESN);
- ii) a more detailed reasoning of the advantages of issuing covered bonds;
- iii) a more thorough analysis of the impact of regulatory harmonisation on cross-border trade (issuance, investing) in covered bonds;
- iv) a discarded option restricted to adjusting the prudential treatment of covered bonds;
- v) a more comprehensive explanation of the 'pass-through effect' assessed in financial literature; and
- vi) a table showing the links between monitoring activity and the benchmark benefits.

The Commission considered a number of policy options for developing covered bond markets and addressing prudential concerns. These differ in terms of the degree of harmonisation, ranging from a non-regulatory option to options involving full harmonisation, as follows:

- Baseline: Do nothing;
- option 1: Non-regulatory option;
- option 2: Minimum harmonisation based on national regimes;
- option 3: Full harmonisation replacing national regimes; and

¹³ *Basel III: finalising post-crisis reforms*, Basel Committee on Banking Supervision (7.12.2017).

¹⁴ SWD(2018) 51 and SWD(2018) 50

- option 4: ‘29th regime’ operating in parallel with national regimes.

Option 1 (non-regulatory) was considered ineffective in achieving the objectives, as there is no guarantee that Member States would follow the best practices. Option 3 (full harmonisation) would probably achieve the objectives, but could disrupt existing well-functioning markets. Option 4 (‘29th regime’ meaning a fully integrated regime for issuers on a voluntary basis as an alternative to national laws on covered bonds, not requiring amendments to existing national laws) depends on industry take-up to be effective. Consultations suggest that such take-up is unlikely; this would undermine the chances of achieving the stated objectives. Also, a parallel regime would contribute to further fragmentation and duplication of costs.

The retained option is option 2 (minimum harmonisation based on national regimes). The retained option achieves most of the objectives of the initiative at reasonable cost. It also balances the flexibility necessary to accommodate Member States’ specificities with the uniformity necessary for coherence at Union level. It is likely to be the most effective in achieving the objectives, while at the same time being efficient and minimising disruption and transition costs. It is also one of the more ambitious options in regulatory terms, while enjoying the most support from stakeholders.

Implementing this option would stimulate the development of covered bond markets where they do not exist or are underdeveloped. It would also lower issuers’ funding costs, help to diversify the investor base, facilitate cross-border investments and attract non-EU investors. Overall, it would reduce borrowing costs.

The option would address prudential concerns, including in relation to market innovation, and secure the prudential benefit of aligning the structural characteristics of the product with preferential prudential treatment at Union level. It would strengthen the protection of investors and its credit-enhancing features would reduce their due diligence costs.

One-off and recurrent direct administrative costs under the preferred option are expected to increase for issuers in low-cost jurisdictions (see impact assessment). Costs would also increase for supervisors. At the same time, issuers would benefit from lower funding costs and in turn citizens would enjoy lower borrowing costs. Costs would not increase for investors, given the lower due diligence costs.

- **Regulatory fitness and simplification**

The package on covered bonds, in particular the Directive accompanying this proposal, aims at harmonising an area currently regulated mainly at national level. The minimum harmonisation in the Directive will bring simplification in terms of basic alignment of core elements of national regimes.

- **Fundamental rights**

The EU is committed to high standards of protection of fundamental rights. In this context, the proposal is not likely to have a direct impact on those rights, as listed in the Charter of Fundamental Rights of the European Union.

4. BUDGETARY IMPLICATIONS

The proposal will have no implications for the Union budget.

5. OTHER ELEMENTS

• **Implementation plans and monitoring, evaluation and reporting arrangements**

The accompanying proposal for a new Directive for covered bonds includes a general plan for monitoring developments in covered bond markets, requiring the Commission to carry out an evaluation of the Directive in close cooperation with the EBA and at least five years after the transposition deadline, and to report to the European Parliament, the Council and the European Economic and Social Committee on its main findings.

The evaluation is to be conducted in line with the Commission's Better Regulation Guidelines. The report is to also cover the issuance of covered bonds in compliance with Article 129 CRR, developments as regards assets collateralising the issuances, and the level of over-collateralisation.

No specific implementation plans or monitoring, evaluation and reporting arrangements are intended for this proposal.

• **Detailed explanation of the specific provisions of the proposal**

Amending Article 129 of Regulation (EU) No 575/2013

Article 129 is amended in order to introduce new requirements on minimum overcollateralisation and substitution assets. Previous provisions governing transparency are moved to the part of the new Directive defining the structural features of covered bonds.

Article 129(1)(d)(ii) and (f)(ii) allows covered bonds to be collateralised by senior units issued by French Fonds Communs de Titrisation or equivalent entities governed by the laws of a Member State that securitise residential or commercial property exposures under certain conditions, including the provision that such units do not exceed 10 % of the nominal amount of the outstanding issue. This possibility is repealed, as only a few national covered bond frameworks allow the inclusion of residential or commercial mortgage-backed securities. The use of such structures is decreasing and is considered to add unnecessary complexity to the covered bond programme.

Other provisions of Article 129 are maintained.

Overcollateralisation

The proposed amendments introduce a new requirement on a minimum level of overcollateralisation (a level of collateral exceeding the coverage requirements). This level is set at 2 and 5%, depending on the assets in the cover pool, based on a nominal calculation method. This level is in line with the advice of the EBA and with the results of the ICF study. While lower than the new Basel standards, it would make the product safer and would raise the level for the majority of Member States where the required minimum level is currently lower.

Repeal of Article 496 of Regulation (EU) No 575/2013

Article 496 allows competent authorities to waive the 10 % threshold referred to in Article 129(1)(d)(ii) and (f)(ii) for certain covered bonds.

As Article 129(1)(d)(ii) and (f)(ii) is repealed the possibility to derogate from the threshold is unnecessary. Article 496 is therefore repealed.

Proposal for a

REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank¹⁵,

Having regard to the opinion of the European Economic and Social Committee¹⁶,

Having regard to the opinion of the Committee of the Regions¹⁷,

Acting in accordance with the ordinary legislative procedure,

Whereas:

- (1) Article 129 of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹⁸ grants, under certain conditions, preferential treatment to covered bonds. Directive (EU) 20xx/xx [OP: Please insert reference to Directive (EU) 20xx/xx on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU] specifies the core elements of covered bonds and provides for a common definition of covered bonds.
- (2) On 20 December 2013 the Commission issued a call for advice to the European Banking Authority (EBA) regarding the appropriateness of the risk weights set out in Article 129 of Regulation (EU) No 575/2013. According to EBA's opinion,¹⁹ the preferential risk weight treatment laid down in Article 129 of that Regulation is, in principle, an appropriate prudential treatment. However, EBA recommended that further consideration be given to the opportunity of complementing the eligibility requirements as set out by Article 129 of Regulation (EU) No 575/2013 to cover, at a minimum, the areas of liquidity risk mitigation, over-collateralisation, the role of the

¹⁵ OJ C , , p. .

¹⁶ OJ C , , p. .

¹⁷ OJ C , , p. .

¹⁸ Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

¹⁹ Opinion of the European Banking Authority on the preferential capital treatment of covered bonds, EBA/Op/2014/04.

competent authority, and the further elaboration of existing requirements on disclosure to investors²⁰.

- (3) In the light of EBA's opinion, it is appropriate to amend Regulation (EU) No 575/2013 by adding additional requirements for covered bonds, thereby strengthening the quality of covered bonds eligible for favourable capital treatment as provided for in Article 129 of that Regulation.
- (4) Pursuant to the third subparagraph of Article 129(1) of Regulation (EU) No 575/2013, competent authorities may partially waive the application of the requirement for exposures to qualify for credit quality step 1, laid down in point (c) of the first subparagraph of Article 129(1), and allow an exposure which qualifies for credit quality step 2 up to a maximum of 10% of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution. Such a partial waiver however applies only after prior consultation with EBA and only provided that significant potential concentration problems in the Member States concerned can be documented as a result of the application of the credit quality step 1 requirement. As the requirements for exposures to qualify for credit quality step 1 as made available by External Credit Assessment Institutions have become increasingly difficult to comply with in most Member States both within and outside the euro zone, the application of that waiver was considered necessary by those Member States which host the largest covered bonds markets. To simplify the use of exposures to credit institutions as collateral for covered bonds and in order to address that difficulty, it is necessary to amend Article 129(1) of Regulation (EU) No 575/2013. Instead of a possibility for the competent authorities to waive the requirements, it is appropriate to establish a rule allowing exposures to credit institutions which qualify for credit quality step 2 up to a maximum of 10% of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution without the need to consult EBA.
- (5) In accordance with points (d)(ii) and (f)(ii) of the first subparagraph of Article 129(1) of Regulation (EU) No 575/2013, loans secured by senior units issued by French *Fonds Communs de Titrisation* or equivalent securitisation entities securitising residential or commercial property exposures are eligible assets which can be used as collateral for covered bonds up to a maximum of 10 % of the nominal amount of the outstanding issue of covered bonds (the '10 % threshold'). However, Article 496 of that Regulation enables competent authorities to waive the 10% threshold. Lastly, Article 503(4) of the same Regulation requires the Commission to review the appropriateness of the derogation enabling competent authorities to waive the 10 % threshold. On 22 December 2013, the Commission requested EBA to provide an opinion in that regard. On 1 July 2014, EBA stated that the use of senior units issued by French *Fonds Communs de Titrisation* or equivalent securitisation entities securitising residential or commercial property exposures as collateral would cause prudential concerns due to the double layer structure of a covered bond programme backed by securitisation units and thereby would lead to insufficient transparency regarding the credit quality of the cover pool. Consequently, EBA recommended that the derogation to the 10 % threshold for senior securitisation units currently laid down in Article 496 of Regulation (EU) No 575/2013 be removed after 31 December 2017²¹.

²⁰ Recommendations EU COM 1-A to 1-D set out in Opinion EBA/Op/2014/04.

²¹ Recommendation EU COM 2 set out in Opinion EBA/Op/2014/04.

- (6) Only a limited number of national covered bond frameworks allow the inclusion of residential or commercial mortgage-backed securities. The use of such structures is decreasing and is considered to add unnecessary complexity to the covered bond programmes. It is thus appropriate to eliminate the use of such structures as eligible assets altogether. Therefore points (d)(ii) and (f)(ii) of the first subparagraph of Article 129(1) of Regulation (EU) No 575/2013, as well as Article 496 of that Regulation should be deleted.
- (7) Intragroup pooled covered bond structures which comply with Regulation (EU) No 575/2013, have also been used as eligible collateral in accordance with points (d)(ii) and (f)(ii) of the first subparagraph of Article 129(1) of that Regulation. Intragroup pooled covered bond structures do not pose additional risks from a prudential perspective because they are not raising the same complexity issues as the use of loans secured by senior units issued by French *Fonds Communs de Titrisation* or equivalent securitisation entities securitising residential or commercial property exposures. According to EBA, collateralisation of covered bonds by pooled covered bond structures should be allowed without limits related to the amount of outstanding covered bonds of the issuing credit institution²². Accordingly, point (c) of the first subparagraph of Article 129(1) should be amended to remove the requirement to apply the limit of 15 % or 10 % in relation to exposures to credit institutions in intragroup pooled covered bond structures. Those intragroup pooled covered bond structures are regulated by Article 9 of Directive (EU) 2014/59/EU. [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU].
- (8) Article 129(3) of Regulation (EU) No 575/2013 requires that the valuation principles for immovable property collateralising covered bonds, set out in Article 229(1) of that Regulation, be applied to covered bonds in order for those bonds to meet the requirements for preferential treatment. The requirements on eligibility of assets serving as collateral for covered bonds relate to the general quality features ensuring the robustness of the cover pool and should therefore be subject to Directive (EU) 2014/59/EU. [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU]. Accordingly, the provisions on valuation methodology should also be subject to that Directive. The regulatory technical standards mandated by Article 124(4)(a) of Regulation (EU) No 575/2013 should therefore not apply in respect of the eligibility criteria for covered bonds as set out in Article 129 of that Regulation. It is therefore necessary to amend Article 129(3) of that Regulation to that effect.
- (9) Limits for Loan-To-Value ('LTV') are a necessary part of ensuring the credit quality of the covered bonds. Article 129(1) of Regulation (EU) No 575/2013 establishes the LTV limits for mortgage and ship assets but does not specify how those limits are to be applied which may lead to uncertainty. The LTV limits should be applied as soft coverage limits, meaning that while there are no limits to the size of an underlying loan, such a loan can only act as collateral within the LTV limits imposed on the assets. The LTV limits determine the percentage portion of the loan that contributes to the requirement of coverage of the liabilities. It is therefore appropriate to specify that the LTV limits apply to the portion of the loan contributing to the coverage of the covered bond.

²² *Ibid.*

- (10) To ensure greater clarity, it should also be specified that the LTV limits are applicable throughout the entire maturity of the loan. The actual LTV should not change but remain at the limit of 80% of the value of the property for residential loans, and at the limit of 60% of the value of the property for commercial loans and ships.
- (11) In order to further enhance the quality of the covered bonds that receive the preferential capital treatment as provided for in Article 129 of Regulation (EU) No 575/2013, that preferential treatment should be subject to a minimum level of overcollateralisation, meaning a level of collateral exceeding the coverage requirements as referred to in Article 15 of Directive (EU) 20... [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU]. Such a requirement serves the purpose of mitigating the most relevant risks arising in case of the issuer's insolvency or resolution.
- (12) One of the requirements laid down in Article 129(7) of Regulation (EU) No 575/2013 is that the credit institution investing in covered bonds receives certain information on the covered bonds on at least a semi-annual basis. Transparency requirements are an indispensable part of covered bonds ensuring a uniform disclosure level and allowing investors to perform the necessary risk assessment, enhancing comparability, transparency and market stability. Therefore, it is appropriate to ensure that transparency requirements apply to all covered bonds which can be achieved by laying down those requirements in Directive (EU) 20... [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU] as common structural feature of covered bonds. Accordingly, Article 129(7) of Regulation (EU) No 575/2013 should be deleted.
- (13) Covered bonds are long term funding instruments and therefore issued with a scheduled maturity of several years. It is therefore necessary to ensure that covered bonds issued before 31 December 2007 or before [OP: Please insert the date of application of this Regulation] are not disrupted. In order to achieve that objective, covered bonds issued before 31 December 2007 should remain exempted from the requirements set out in Regulation (EU) No 575/2013 with respect to eligible assets, overcollateralisation and substitution assets. In addition, other covered bonds complying with Article 129 of Regulation (EU) No 575/2013 and issued before [OP: Please insert the date of application of this Regulation] should be exempted from the requirements on overcollateralisation and substitution assets and should continue to be eligible for the preferential treatment as set out in that Regulation until their maturity.
- (14) This Regulation should be applied in conjunction with [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU]. In order to ensure the consistent application of the new framework establishing the structural features of the issue of covered bonds and the amended requirements for preferential treatment, the application of this Regulation should be deferred to coincide with the date from which Member States are to apply the provisions transposing that Directive.
- (15) Regulation (EU) No 575/2013 should therefore be amended accordingly.

HAVE ADOPTED THIS REGULATION:

Article 1
Amendments to Regulation (EU) No 575/2013

Regulation (EU) No 575/2013 is amended as follows:

1. Article 129 is amended as follows:

(a) paragraph 1 is amended as follows:

(i) the first subparagraph is amended as follows:

— the introductory phrase is replaced by the following:

"To be eligible for the preferential treatment set out in paragraphs 4 and 5, covered bonds, as referred to in Article 2 of Directive (EU) 20xx/xxxx of the European Parliament and of the Council*[OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU], shall meet the requirements set out in paragraphs 3, 3a and 3b of this Article and shall be collateralised by any of the following eligible assets:

* [OP, please insert a reference to Directive (EU) 20xx/xx of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU (OJ C [...], [...], p. [...]).";

— point (c) is replaced by the following:

"(c) exposures to credit institutions that qualify for the credit quality step 1 or credit quality step 2 as set out in this Chapter.";

— in point (d), point (ii) is deleted;

— in point (f), point (ii) is deleted;

(ii) the second subparagraph is replaced by the following:

"For the purposes of point (c) of the first subparagraph, exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the limits referred to in those points.";

(iii) the third subparagraph is deleted;

(b) the following paragraphs 1a, 1b and 1c are inserted:

"1a. For the purposes of point (c) of the first subparagraph of paragraph 1, the following shall apply:

(a) for exposures to credit institutions that qualify for the credit quality step 1 the exposure shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution;

(b) for exposures to credit institutions that qualify for the credit quality step 2 the exposure shall not exceed 10 % of the total exposure of the nominal amount of outstanding covered bonds of the issuing credit institution;

(c) the total exposure to credit institutions that qualify for the credit quality step 1 or the credit quality step 2 shall not exceed 15 % of the total exposure of the nominal amount of outstanding covered bonds of the issuing credit institution.

This paragraph shall not apply to the use of covered bonds as eligible collateral as permitted pursuant to Article 9 of Directive (EU) 20xx/xxxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU].

1b. For the purposes of point (d)(i) of the first subparagraph of paragraph 1, the limit of 80 % shall refer to the portion of the loan contributing to the coverage of liabilities attached to the covered bond and be applicable throughout the entire maturity of the loan.

1c. For the purposes of point (f)(i) and point (g) of the first subparagraph of paragraph 1, the limit of 60 % shall refer to the portion of the loan contributing to the coverage of liabilities attached to the covered bond and be applicable throughout the entire maturity of the loan.";

(c) paragraph 3 is replaced by the following:

"3. For immovable property collateralising covered bonds compliant with this Regulation, the requirements set out in Article 208 shall be met.";

(d) the following paragraphs 3a and 3b are inserted:

"3a. In addition to being collateralised by the eligible assets listed in paragraph 1, covered bonds shall be subject to a minimum level of 5 % of overcollateralisation as defined in Article 3(12) of Directive (EU) 20xx/xxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU].

For the purposes of the first subparagraph, the total nominal amount of all assets in the cover pool shall be at least of the same value as the total nominal amount of outstanding covered bonds ('nominal principle') and consist of eligible assets as set out in paragraph 1.

The assets contributing to a minimum level of overcollateralisation shall not be subject to the limits on exposure size as set out in points (b) and (c) of the first subparagraph of paragraph 1 and shall not count towards those limits.

Competent authorities designated pursuant to Article 18(2) of Directive (EU) 20xx/xxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU] may decide to apply a lower minimum level of overcollateralisation to covered bonds provided that the following conditions are met:

(a) the calculation of overcollateralisation is either based on a model which takes into account the assigned risk weights of the assets or a model where the valuation of the assets is subject to mortgage lending value as defined in Article 4(1)(74);

(b) the minimum level of overcollateralisation cannot be lower than 2 % based on the nominal principle.

3b. Eligible assets referred to in paragraph 1 may be included in the cover pool as substitution assets as defined in Article 3(11) of Directive (EU) 20xx/xxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU] for the primary assets as defined in Article 3(10) of that Directive, subject to the limits on credit quality and exposure size as set out in paragraph 1 of this Article.";

(e) paragraphs 6 and 7 are replaced by the following:

"6. Covered bonds issued before 31 December 2007 shall not be subject to the requirements of paragraphs 1, 3, 3a and 3b. They shall be eligible for the preferential treatment under paragraphs 4 and 5 until their maturity.

7. Covered bonds issued before [OP please insert the date of application of this amending Regulation] shall not be subject to the requirements of paragraphs 3a and 3b. They shall be eligible for the preferential treatment under paragraphs 4 and 5 until their maturity."

(2) in point (a) of Article 416(2), point (ii) is replaced by the following:

"(ii) they are bonds as referred to in Article 2 of Directive (EU) 20xx/xxxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU] other than those referred to in point (i) of this point;"

(3) in Article 425, paragraph 1 is replaced by the following:

"1. Institutions shall report their liquidity inflows. Capped liquidity inflows shall be the liquidity inflows limited to 75 % of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions and qualifying for the treatments set out in Article 113(6) or (7) from this limit. Institutions may exempt liquidity inflows from monies due from borrowers and bond investors related to mortgage lending funded by bonds eligible for the treatment set out in Article 129(4), (5) or (6) or by covered bonds as referred to in Article 2 of Directive (EU) 20xx/xxxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU] from this limit. Institutions may exempt inflows from promotional loans that the institutions have passed through. Subject to the prior approval of the competent authority responsible for supervision on an individual basis, the institution may fully or partially exempt inflows where the provider is a parent or a subsidiary institution of the institution or another subsidiary of the same parent institution or linked to the institution by a relationship within the meaning of Article 12(1) of Directive 83/349/EEC.";

(4) in point (b) of Article 427(1), point (x) is replaced by the following:

"(x) liabilities resulting from securities issued qualifying for the treatment set out in Article 129(4) or (5) or as referred to in Article 2 of Directive (EU) 20xx/xxxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU];"

(5) in point (h) of Article 428(1), point (iii) is replaced by the following:

"(iii) match funded (pass-through) via bonds eligible for the treatment set out in Article 129(4) or (5) or via bonds as referred to in Article 2 of Directive (EU) 20xx/xxxx [OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision amending Directive 2009/65/EU and Directive 2014/59/EU];"

(6) Article 496 is deleted;

(7) in point 6 of ANNEX III, point (c) is replaced by the following:

"(c) they are covered bonds as referred to in Article 2 of Directive (EU) 20xx/xxxx[OP: Please insert reference to Directive (EU) on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU] other than those referred to in point (b) of this point.".

Article 2

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [date from which Member States are to apply the provisions transposing Directive (EU) .../... on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EU and Directive 2014/59/EU].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

For the European Parliament
The President

For the Council
The President