ASCB
Association of Swedish Covered Bond issuers
The Covered Bond Voice of the Swedish Bankers' Association

Our reference: 2015/12/010

05/01/2016

European Commission

Covered bonds in the European Union

Consultation document

This document is supplementary to ECBCs response dated 16 December 2015 to the European Commission's consultation document on covered bonds in the European Union, and sets out additional comments from the Swedish covered bond issuers (through ASCB). If this document is silent on a question or matter, the Swedish issuers generally concur with the views expressed in the ECBC response.

General Comments

ASCB does not agree with the Commission's hypotheses regarding market fragmentation and its causes or on the supposed effects of a more harmonized regulatory framework. In general, ASCB believes that the negative effects far outweigh the positive effects of a harmonization. The differences between e.g. German covered bonds and covered bonds in more peripheral countries, during the crisis, was not caused solely by differences in legal frameworks. There were a lot of real differences in the credit risks that investors experienced when they were choosing between peripheral and German covered bonds. That cannot be changed with a harmonized regulation. In a completely harmonized regulation it would have been more obvious that the credit risk in certain countries would have been worse and therefore the value of those bonds would have been lower.

ASCB is critical to the idea of harmonization because it will not, and cannot, cover all legal frameworks that surround and support a covered bond regulation. The national covered bond regulation is part of a bigger package of regulations which together makes the issuance of covered bonds possible. Such package includes everything from insolvency regulation to credit regulation and regulations on valuation. These "associated rules" are not always in the form of laws but they are nonetheless important for the whole framework to function. If the covered bond legislation were to be harmonized it is possible that the harmonized rule would not function together with national insolvency or resolution regulations or the rest of the associated rules. This would likely end up in a less functional legal system. ASCB is not aware of any realistic plans in the near future to implement harmonization of national insolvency law, tax regulations, valuation standards etc and until such harmonization is achieved it is our view that a harmonization of covered bond legislation will be very

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difficult to achieve. Also, ASCB would like to express our concern that a harmonized covered bond regulation might cause problems in a market that is functional today and has been so for many years.

As mentioned above ASCB sees that there are many fundamental differences between the different legal systems in Europe that cannot be ignored, which also affects how a covered bond structure is set up. It is important that a harmonisation does not endanger existing covered bond structures in various jurisdictions, which includes local currency markets. It is of utmost importance that the features of these markets are taken into consideration in the legislative process. Also, in this context it should be noted that market practice has proven to be an efficient way to find errors in a national regulation. If a national regulation contains features that investors believe could be improved it will be seen in the prizing of the bonds under that legislation. It is less complicated for the national regulator to handle such an error if necessary. In case of an EU regulation, the process to handle such an error will take more time, which could affect the covered bond market in a negative way.

ASCB believes there are some important factors that already today are harmonizing the covered bond regulations, directly or indirectly. First of all there are several EU regulations that refer to covered bonds. Most important are probably CRR, EMIR and UCITS. ASCB sees some problems with article 129 in CRR which is a key provision and it will be even more important when LCR is fully implemented. Banks will then be a larger investor base and therefore the impact of capital regulations on the covered bond market will increase. It will not be possible for large issuers to issue covered bonds under a law that is not in line with CRR. Also, the way the European regulators are making references to article 129 in other legislative documents means that this article is of more direct importance to the issuers even though that article originally was intended for requirements for preferential treatment. One example of such reference in other legislative documents is the exemption from clearing of OTC-derivatives relating to covered bonds which require compliance with article 129. This is somewhat of a strange requirement since a preferential treatment of covered bonds for an investor has nothing to do with the possibility and suitability of a covered bond swap to be subject to clearing. This was also highlighted by ECBC in their responses to the various consultations on OTC clearing where ECBC suggested a more suitable reference to the UCITS definition. However, irrespective of in which regulatory framework the definition of "covered bond" is situated, it is of key importance that the rule makers take great care to make necessary adjustments to the definition when it is cross referred to in other regulation. The extent of such adjustments is a function of who detailed the definition in article 129 in CRR becomes.

It is also important to factor in the significant work that ECBC does for the harmonization in Europe, especially the work in relation to transparency.

Our conclusion is that we do not favour the idea of harmonizing each national covered bond legislation. However, if further convergence would nevertheless be the case this could preferably be achieved through option 1, i.e. an indirect harmonization through a recommendation addressed to Member States in combination with an improved/complemented Article 129 CRR.

Specific Key Issues

From a Swedish perspective, ASCB would like to highlight the following issues which are of specific importance in relation to the Swedish covered bond market and the consultation:

- Any requirements with respect to the valuation methodology and LTV calculation to be applied should be principles based and should accommodate established market practices. In particular, any standards adopted should not interfere with the underlying mortgage market and corresponding practices.

- ASCB would like to highlight that market value is an established market practice and that LTV limits should be used to determine contribution to coverage only, thus not "loan in/out" neither at inception nor on an on-going basis

- There should definitely not be any requirement for first priority mortgage; LTV and other restrictions are sufficient. Since the mortgage systems differs between legislations it is important to consider all nuances of a mortgage collateral system rather than relying on simplified notions such as "first mortgage" and "second mortgage".

- In general ASCB does not believe that there should be specific requirements for the derivatives, more than perhaps that they should only be used for hedging purposes and should continue after an issuer event of default. Intra-group hedging should definitely be permitted. The prohibition of intra-group hedging is unachievable. It should also be noted in this context that for a local currency market intra-group hedging is of particular importance and a prohibition would be detrimental for the covered bond market in such local currency market.

QUESTIONS - COVERED BOND MARKETS: ECONOMIC ANALYSIS

1. In your opinion, did pricing conditions in European covered bond markets converge and diverge before and after 2007, respectively? If so, what where the key drivers of this convergence/divergence? Please, provide evidence to support your view.

2. Was pricing divergence an evidence of fragmentation between covered bonds from different Member States? Do you agree with the reasons for market fragmentation described in section 2.1 of Part I? Were there any other reasons?

No, it was not. Spread widening across covered bond sectors did happen during the sovereign crisis. This widening was however more a sign of covered bonds not being able to fully delink from their underlying sovereign and fragmentation in sovereign markets than fragmentation that would have come from within the covered bond market.

The primary reasons for the divergence relates to the first 2 points in section 2.1, Part I i.e. the risk assessment of the cover pool/credit rating of the issuer and the sovereign.

In our opinion, the potential fragmentation of covered bonds markets in the EU observed during this period of time does not reflect a loss of confidence of the investors in covered bond products or the absence of a common European regulatory framework but only reflects the minimum pricing requested by investors to cover the intrinsic country related risks in covered bond products as well as the impact the sovereign has on the quality of the different underlying cover assets. Together with the link to government bonds also national supervisory architecture and a lack of common vision played a role.

3. In your view, is there any evidence of pricing differentiation/fragmentation between covered bond issuers on the basis of size and systemic importance, as well as their geographical location?

ASCB agrees with ECBC.

4. Is there an appropriate alignment in the regulatory treatment between covered bonds and other collateralised instruments? If there is a misalignment, could you illustrate what differences in regulatory treatment you deem as inappropriate and why?

ASCB agrees with ECBC.

5. Are operational costs for covered bond issuance lower than for other collateralised instruments? Can you quantify the respective costs, even if only approximately?

ASCB agrees with ECBC.

6. Are there significant legal or practical obstacles to:

a) cross-border investment in covered bond markets within the Union and in third countries?; and

b) issuance of covered bonds on the back of multi-jurisdictional cover pools?

Please provide evidence to support your views.

There are no significant legal or practical obstacles with regard to cross-border investments.

In respect of issuances backed by multi-jurisdictional cover pools those could offer some practical and legal challenges to any form of collateralised funding, but it should be up to the national covered bond legislation to allow for multi-jurisdictional cover pools.

QUESTIONS – LEGAL FRAMEWORK AND INTEGRATION

1. Would a more integrated "EU covered bond framework" based on sound principles and best market practices be able to deliver the benefits suggested in section 2 of Part II? Are there any advantages or disadvantages to this initiative other than those described in section 2 of Part II?

ASCB is not convinced that a more integrated "EU covered bond framework" would have all the benefits suggested in the consultation or would benefit the Swedish covered bond market. Even if there would be a harmonized framework, bonds in different currencies will be traded in different markets. Investors would still need to consider other related regulations when investing in covered bonds and Issuers would still need to explain these variations to the investors. ASCB does not believe that a more integrated market would automatically render a more disciplined and efficient market. There would still be a need for investors to do its due diligence and therefore ASCB doubts that the outcome of a more integrated framework would have all the suggested benefits.

2. In your view, are market-led initiatives such as the "Covered Bond Label" sufficient to better integrate covered bond markets? Should they be complemented with legislative measures at Union or Member State level?

The role played by the Covered Bond Label in order to achieve better integration and improve transparency of the Covered Bond Markets in Europe has been important.

3. Should the Commission pursue a policy of further legal/regulatory convergence in relation to covered bonds as a means to enhance standards and promote market integration? If so, which of the options suggested in section 3 of Part II should the Commission follow to that end and why?

ASCB promotes option 1 i.e. an indirect harmonization through a recommendation addressed to Member States in combination with an improved/complemented Article 129 CRR. Such a convergences should be based on the principle of competition of covered bond regimes, which have proven to be an efficient approach towards further convergence in the past, as diversity of national systems drives best practice principles and competition. Employing indirect harmonization to the CB space will beneficially allow for the preservation of domestic frameworks insofar as permitted by harmonisation aims. Option 1 also has the additional benefit of being capable of introduction without legislative measures (via e.g. the Covered Bond Label), which facilitate harmonisation in the timeliest fashion of the options proposed.

4. Specifically, if the Commission were to issue a recommendation to Member States as suggested in section 3 of Part II would you consider that sufficient or should it be complemented by other measures (both legislative and non-legislative)? (see question 8 below)

ASCB believes that a recommendation can be complemented by a definition of covered bonds that is more general then the one seen in CRR article 129.

5. On the suggested list of high level elements for an EU covered bond framework:

a) is the list sufficiently comprehensive or should it include any other items?

b) should the Commission seek to develop all the elements or a subset of them?

c) if only a subset, should the Commission give priority to the target areas identified by the EBA Report: (i) special public supervision of cover pools and issuers; (ii) characteristics of the cover pool; and (iii) transparency?

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6. What are your views on the merits described under section 3 of Part II of using different legal instruments to develop an EU covered bond framework? In particular, would it be desirable to harmonise through a directive some of the legal features of covered bonds and requirements applicable to them under Member States' laws? If it were proposed, how could a 29th Regime on covered bonds be designed to provide an attractive alternative to existing national laws?

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7. How should an EU covered bond framework deal with legacy transactions?

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8. Would you view a combination of recommendations to Member States (Option 1) and targeted harmonisation of certain minimum standards (Option 2) as desirable and sufficiently flexible? If so, what should be the subject of each option?

ASCB support a recommendation. ASCB believes it is important that all types of integration of regulations regarding post insolvency should be kept very flexible so it will be able to handle national insolvency regulation.

QUESTION – COVERED BOND DEFINITION

What are your views on the proposals set out in section 1 of Part III for a "new legal definition" of covered bonds to replace Article 52(4) of the UCITS Directive?

ASCB supports the European Commission proposal of strengthening the covered bond definition, thus replacing the current definition set out in the UCITS directive. ASCB also support the proposed "new legal definition" of covered bond, as it would provide more certainty to the covered bond framework and also help protect the term in light of current innovation initiatives. The definition should be more general than the one in CRR article 129.

As mentioned in the General Comments section above ASCB has noted that several EU frameworks (e.g. EMIR) refer to the covered bond definition in CRR Article 129. This is unfortunate since that definition is intended for preferential capital treatment and is not suited as a general definition to be used in other contexts. A new general covered bond definition, broader than the art 129 definition, could be useful to replace any references to the art 129 definition in other EU frameworks not aimed at preferential capital treatment.

QUESTIONS – ISSUER MODELS AND LICENSING REQUIREMENTS. ROLES OF SPVs

1. Should the current licensing system be simplified to require a "one-off" authorisation only for all covered bond issuers based on common high level standards? What specific prudential requirements (that is, in addition to those in CRR and CRD) could be applied as a condition for granting a covered bond issuer license?

ASCB do not consider that issuer models and/or licensing requirements are suited for integration through harmonization. Moreover, ASCB do not consider that the current requirements determined by member states are in need of streamlining.

2. If the covered bond issuer is subject to a one-off covered bond-specific licence, what would be the additional benefits of requiring that each covered bond programme be subject to prior authorisation as well? Alternatively, would pre or post notification to the competent authority of the programme and of each issue within or amendment to the programme suffice? How should "covered bond programme" be defined for these purposes?

ASCB considers that the term "covered bond programme" should be equal to that of a particular cover pool. If this is the definition then a separate authorisation should not be required. Each such cover pool already falls within the one-off licence and is thereby under on-going supervision by the competent authority hence an additional licence would only cause additional administrative burden on the issuer and on the competent authority for no apparent benefits. ASCB does not agree that separate authorisation shall be required in relation to each issue or each documentary platform (funding program) for issuance against the same cover pool.

3. Should the Framework explicitly allow the use of SPVs to ring-fence cover pools of assets backing issues of covered bonds? What specific requirements should apply to these SPVs?

The framework should not be so prescriptive as to specify the method of segregation. Nor should it prohibit a specific mechanism. A legal opinion and/or recognition of segregation in law should be sufficient, whatever structural mechanism chosen. However, it is important that there is a legal/regulatory framework that sets out the key elements of the covered bond framework and that it does not only rely on contractual arrangements (such as in traditional securitisations).

4. Regarding the use of pooled covered bonds structures and SPVs:

a) would it be desirable for an EU covered Bond Framework to allow the use of these structures and why? What legal structures are used in your jurisdiction to pool assets from different lenders or issuers?

b) which approach would be the most suitable for pooling assets across borders?

c) where the issuer of pooled covered bonds is an SPV, should this issuer be regulated as a credit institution or as some other form of legal entity?

The framework should not be so prescriptive as to specify a method of structure, nor should it prohibit a specific structure.

QUESTIONS – ON-GOING SUPERVISION AND MONITORING OF COVER POOLS (PRE-INSOLVENCY)

1. In your view, would it be desirable for an EU covered bond Framework to set common duties and powers on competent authorities for the supervision of covered bond programmes and issuers? What specific duties and powers should be included in the Framework and/or EBA or ESMA Guidelines?

ASCB agrees with ECBC.

2. What are your views on the proposals set out in subsection 2.2 of Part III on the appointment of and legal regime for cover pool monitors?

ASCB has nothing to add to the proposal in subsection 2.2 of part III.

QUESTION – COVERED BONDS AND THE SSM

Should the ECB have specific supervisory powers, and if so which ones, in relation to covered bond issuance of credit institutions falling within the scope of the SSM?

Since Sweden is not part of SSM our comment is that it is important to acknowledge the fact that the SSM will not be relevant with respect to all relevant covered bond jurisdictions in Europe.

QUESTION – DUAL RECOURSE PRINCIPLE

Do you agree with the proposed formulation for "dual recourse"?

ASCB agrees that the dual recourse principle should be anchored in a common European CB framework. However, the definition might need further refinement, e.g. swap counterparties should have the same priority as the bondholders.

QUESTIONS – SEGREGATION OF THE COVER ASSETS

1. Are there any advantages to using an SPV as an additional segregation mechanism at issuance? Are cover assets typically transferred to the SPV at issuance via legal or equitable assignment?

This question points towards a preference for traditional securitisation structures rather than current covered bond frameworks which rely on a fundamental anchoring in a framework prescribed by law. The framework should not be so prescriptive as to specify a method of structure, nor should it prohibit a specific structure. Necessary segregation can be achieved by way of contractual means and SPV structures as well as by way of a legal/regulatory framework. What method is most appropriate for a particular jurisdiction depends to a large extent on the local legal position on matters of company law, insolvency law, contract law and rights in rem.

2. In your jurisdiction, what legal and practical steps are required in order to segregate effectively the cover assets from the issuer's insolvent estate or in resolution? Would it be necessary to serve a notification to each borrower of the issuer? Until notification is served, what is the legal status of any proceeds of the cover assets which may be paid directly into the insolvent estate or to the issuer in resolution?

The assets registered in the cover pool register will be "segregated" following bankruptcy of the issuer.

QUESTIONS – LEGAL FORM AND SUPERVISION OF THE COVER POOL

1. Should the cover pool be incorporated as a regulated entity? In that case, what type?

ASCB believes that this should not be regulated by EU. This must be in line with national regulation regarding corporate law and insolvency. If the requirement of a regulated entity would be introduced, the market will be less effective because there is a risk that such requirement would not conform to national regulations.

2. Who should be the supervisory authority for these purposes, the competent authority or the resolution authority?

This must be handled through national regulations. Although it is reasonable to believe that the resolution authority would handle a situation where an issuer is in resolution while the competent authority would handle an insolvency situation.

QUESTIONS – SPECIAL ADMINISTRATOR OF THE COVER POOL

1. What are your views on the proposals set out in subsection 3.3 of Part III on the appointment and legal regime for a cover pool special administrator?

ASCB agrees with the duties in general, but a framework should be principle based and not too detailed. Rules and procedures for the appointment of special administrators varies between each jurisdiction and there is no reason to prescribe or prohibit a specific way.

2. Should the special administrator be obliged to report regularly to the relevant supervisory authority? Should the content and regulatory of such reporting be the same as for the issuer?

Yes, but the format and frequency of reporting shall be left to national covered bond legislation to decide.

QUESTIONS – RANKING OF COVER POOL LIABILITIES

1. Do you agree with the suggested ranking for cover pool liabilities? Is the wording proposed in subsection 3.3 of Part III sufficient to define clearly the claims that may arise, avoid confusion between claims and prevent claims in an unreasonable amount from arising?

No. Any ranking in the cover pool assets when it is controlled by the cover pool administrator is not workable and could make the task of the cover pool administrator impossible. Unlike an insolvency administrator, a cover pool administrator cannot stop payments but has to meet obligations from the covered bonds when they become due. He has also permanently to pay for services in order to run the cover pool. This is not a dead pool awaiting dissolution or liquidation, but for many years a going concern. All liabilities that are secured by the cover pool must rank pari passu. The priority claim of the covered bond investors is realized by the fact that they have now a claim to the cover pool. If some countries should provide priorities within the cover pools it should first be understood how this would be made workable and then be made an option.

2. Is it possible to define hedging activity better and, if so, how?

ASCB does not see the need to define hedging activity further. There is a substantial risk such attempt of defining hedging activity could be partial and exclusive. This would be detrimental to the functioning of EU covered bond markets.

Any definition of hedging activity should be left to national regulation.

1. Are current provisions in EU law sufficient to deliver effective protection for bondholders in a resolution scenario involving covered bonds? In particular, is it sufficiently clear:

a) how the cover pool would be segregated under each possible resolution or recovery scenario of the issuer?

b) how the full recourse against the issuer would take effect if the issuer is in resolution and is not placed subsequently into liquidation?

c) what procedural steps should be followed in resolution and by whom in order to make effective the dual recourse mechanism?

QUESTIONS – INTERACTION BETWEEN COVER POOL AND ISSUER IN INSOLVENCY/RESOLUTION

This is closely related to national insolvency laws and are therefore difficult to have a harmonized approach to. In respect of the implementation of BRRD it is yet too early to comment on if the resolution mechanism will be efficient and sufficient.

2. Should the Framework provide for a cut-off mechanism as suggested in subsection 3.4 of Part III? In particular, should such a cut-off mechanism:

a) preclude the closure of insolvency or resolution before possible residual claims from the covered bondholders against the issuer or the insolvent estate have been identified and quantified?

b) set out clear and objective requirements on the valuation of the cover pool and the timing for such valuation?

c) extinguish the residual claim on the estate or the successor credit institutions after sufficient assets have been segregated for the benefit of covered bondholders at the outset of the resolution or insolvency proceedings?

d) give specific powers and duties to the resolution authority and, if so, what should those consist in?

No cut-off requirement should be introduced. This is closely related to national insolvency laws and therefore difficult to have a harmonized approach to. ASCB thinks this should be up to national regulations.

QUESTIONS – RESIDENTIAL AND COMMERCIAL LOANS

1. Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets? Should certain riskier residential or commercial loans (ie buy-to-let mortgages; second home loans; loans to real estate developers; etc.) be excluded from the cover pool or permitted subject to stricter criteria?

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2. In relation to mortgage loans:

a) what are your views on the proposed requirements on "perfection of security" and "first ranking mortgage"? Is registration of the security a requirement for perfection in your jurisdiction?

b) is the enforceability of mortgages in the different Member States equivalent or should there be additional requirements to ensure their equivalence?

c) are minimum standards for mortgage rights in third countries necessary?

ASCB advocates a principles-based approach that does not override national legislation. In principle, ASCB think no category of mortgage loan should be excluded as collateral, but that the issuer should give appropriate disclosure to the investors as per the inclusion of any such assets in the cover pool.

This is too detailed and should be subject to national legislation since the concept of mortgages, the meaning of priority rights and the perfection of security differs between various jurisdictions. There should definitely not be any requirement for first priority mortgage; LTV and other restrictions are sufficient. Since the mortgage systems differs among the member states, it is important to consider all nuances of a mortgage collateral system rather than relying on simplified notions such as "first mortgage" and "second mortgage".

3. In relation to LTVs:

a) what are your views on the proposals set out in subsection 4.1 of Part III on minimum LTVs?

b) in the case of insured properties, should higher LTV limits be allowed if the insurance cover meets certain requirements and, if so, what should such requirements be? In what other cases should higher LTV limits be allowed?

Could loan-to-income requirements be used to replace or complement LTV limits?

c) should there be an additional average LTV eligibility limit at portfolio level?

d) with the advent of a Binding Technical Standard defining Mortgage Lending Value, is it appropriate to apply this for eligibility in all cover pools across the Union as a prudent measurement?

e) should LTV limits be used to determine: eligibility (loan in/out) of loans at inception? Eligibility (loan in/out) of loans on an ongoing basis? Should they instead be used to simply determine contribution to coverage? A combination of the above?

ASCB would like to highlight that market value is an established market practice and must be accepted and that LTV limits should be used to determine contribution to coverage only, thus not "loan in/out" neither at inception nor on an on-going basis.

Any requirements with respect to the valuation methodology and LTV calculation to be applied for these purposes should be principles based and should accommodate established market practices. In particular, any standards adopted should not interfere with the underlying mortgage market and corresponding practices.

Given the information disclosed with respect to the cover pool, including as contemplated by the ECBC Harmonised Transparency Template investors will be able to assess LTV levels across the pool and also the performance levels of the assets in the pool, and to make their investment decision on that basis

4. In relation to the valuation of cover assets:

a) how frequently should the value be updated and in which way (revaluation, update of the initial valuation, and in which way)?

b) what criteria should be applied to (i) the valuer and (ii) the valuation process to ensure that they meet the transparency and independence principles set out in the first and second subparagraphs of Article 229(1) CRR?

ASBC agrees in general with ECBC

5. Should the Framework adopt the definition of "non-performing exposures" as set out in the EBA's draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-performing Exposures?

A general definition that is harmonized with the CRR concept of non-performing exposures might be considered.

6. In light of the EBA's prudential concerns in relation to the use of RMBSs and/or CMBSs in cover pools, should the Framework exclude these assets completely from qualifying as cover assets (including, for these purposes, as substitution assets) or should they be allowed only subject to strict criteria and within the 10% limit currently permitted under Article 129 of the CRR? What is the added value and practical uses of RMBS/CMBS as collateral in your jurisdiction/issuer?

Yes, exclude the ABSs from the pools.

QUESTIONS – PUBLIC SECTOR LOANS

1. What are your views on the proposals for public sector loans as cover assets set out in subsection 4.1 of Part III?

Any EU-wide harmonization in these areas could cause severe damages on national level. The decisive question is, what the member states - according to their national law - interpret as being part of the "public sector". Because of the (traditionally developed) national particularities, before discussing the harmonization of quality requirements, a fundamental analysis should be made on how the national CB eligibility criteria for public debt are defined in detail.

2. What eligibility requirements in terms of validity and enforceability should apply to the guarantee granted by the relevant public sector entity?

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QUESTIONS – OTHER ASSET CLASSES: AIRCRAFT, SHIP AND SME LOANS

1. Should the Framework exclude aircraft, ship and SME loans from cover pools or should they be allowed only subject to strict criteria and limits? If so, what criteria and limits should be applied?

ASCB believes the framework should exclude aircraft, ship and SME loans from cover bonds pools. Such funding can be handled in other ways but not within this cover bond definition.

2. In relation to SME loans, is it possible to identify a category of "prime" SME loans as a potential eligible asset class for cover pools?

No, ASCB sees no reason to identify any "prime" SME loans.

QUESTIONS – MIXED POOLS AND LIMITS ON EXPOSURES

1. Do you agree that mixed-asset cover pools should be allowed?

ASCB supports the idea to allow mixed pools. By mixed pools ASCB means pools containing real property related mortgage loans and public loans. These pools can also include substitute assets. Generally, the use of mixed cover pools helps to diversify the risks for the issuer and allows reaching a minimal size of the cover pool under LCR standards. The minimum disclosure requirements provided by European legislation and national law and the additional standards set up by the Covered Bond Label at European and global level (such as the Harmonised Transparency Template) provide investors with

high quality detailed and comparable information on the cover pool and thus guarantee an optimal transparency of the mixed pool structure.

2. What are your views on the proposed limits on specific assets and concentration of exposures? Should any other limits or requirements apply?

ASCB believes that there can be a limit for commercial loans at 10 percent, provided that agricultural loans are not included in the definition of commercial loans. The share can vary but never exceed this limit. If the rest is just mortgage loans and public loans there should be no concentration limit at the level of the individual obligor's name in the underlying exposures and/or to exposures to credit institutions. Further, it is important with flexibility on exposure to credit institution as currently set out in article 129 (e.g. that credit rating can be used with lower exposure limit). It could also be clarified that exposures to swap counterparties are not included in the "credit institution exposure limit".

QUESTIONS – COVERAGE REQUIREMENT

1. Which option should be preferred for the Framework to formulate the coverage requirement and why?

a) a general requirement along the lines of Article 52(4) of the UCITS Directive, amended to include the wording suggested by the EBA;

b) a nominal coverage;

c) a net-present value coverage;

d) a net-present value coverage under stress; or

e) any other or a combination of the some or all of the above.

When calculating the coverage only liabilities towards bondholders and swap counterparties should be included, thus not cost or liabilities for managers, administrators etc.

2. If the coverage requirement were formulated as net-present value coverage under stress, should the stress tests be specified in any form in the Framework or ESMA/EBA regulatory guidelines? If so, what specific stress tests should be required and why?

ASCB sees no reason why this should be harmonized. This should be a normal routine in the supervision by the cover pool monitor or the competent authority.

3. Should derivatives entered into in relation to the cover pool be taken into account for the purpose of determining the coverage requirement? If so, what valuation metric should be used for these purposes?

The only purpose of derivatives is protection against interest rate and/or currency risk rather than collateralizing covered bonds. Therefore, derivatives represent neither "orderly" cover assets nor "substitution" assets. Depending on market fluctuations of interest and forex rates, however, the net derivative exposure varies over time. Therefore, derivatives need to be taken into account in the net-present value calculation.

4. What exposures to credit institutions within the pool should be taken into account to determine the coverage requirement and why?

Collateralised derivatives entered into with high-quality counterparties should not count towards exposures to financial institutions. In other words, derivatives should not be included as counterparty exposures the calculation of CRR 129 1(c).

QUESTIONS – OVERCOLLATERALISATION

1. Should a quantitative mandatory minimum OC level be set in the Framework? If so, what should that level be and should it be the same for all types of covered bonds?

If the framework could replace other EU-frameworks it could be possible to quantify an OC-requirement that is in line with market expectations. What ASCB understands a requirement of 2 percent should be possible to introduce. In that case it would be enough to handle the requirements formulated in delegated act concerning waiving of clearing obligations under EMIR.

2. If a mandatory minimum OC level were set in the Framework, should there be exceptions to the requirement? (for example where the issuer applies a precise "match funding model" or where certain targeted liquidity and market risk mitigation measures are used – see subsection 4.3 of Part III)

No. In ASCBs opinion this would not be helpful for the transparency and comparison across different Covered Bonds.

3. Should the Framework set a maximum level of permitted OC? If so, when and at what level?

ASCB does not see any beneficial effects for Covered Bond holders or issuers. Moreover, there might be times where appropriate instruments to address risks

like interest rate or currency risk are not available, which would automatically lead to higher OC needs from rating institutions. Setting a maximum OC could also increase rating volatility as rating agencies put a high emphasize on OC.

There are other, more appropriate, means of mitigating any risks with respect to OC levels. Various general considerations may determine the level of OC within programmes and a rigid approach to introducing a maximum level may interfere with the usual management of these considerations.

4. Should the Framework provide for the treatment of voluntary OC in the event of insolvency/resolution of the issuer?

With regard to resolution, "voluntary OC" has to be protected. According to Article 34 (g) BRRD, "no creditor shall incur greater losses than would have been incurred if the institution…had been wound up under normal insolvency proceedings…". As "voluntary" OC is protected under insolvency procedures and might be needed to redeem covered bonds, "voluntary" OC must be protected in the event of resolution of the issuer, too. Otherwise, the Framework would violate the BRRD.

The Framework should clearly stipulate that all assets which are part of the cover pool (or transferred to an SPV) at the time of the issuer's insolvency or at the time of the appointment of a cover pool administrator can be used to redeem the outstanding covered bonds in full and on time. In addition, one has to keep in mind that assets remaining after covered bond creditors are satisfied and management costs are paid have to be surrendered to the insolvent estate. Although the voluntary OC must be voluntary and a level of OC in the beginning of a post insolvency period cannot be forced to be kept.

QUESTIONS – MARKET AND LIQUIDITY RISKS

1. In your view, are OC levels adequate to mitigate market and liquidity risks in the absence of targeted measures such as those described in subsection 4.3 of Part III?

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2. Should the Framework lay down specific requirements on the use of derivatives as suggested in subsection 4,3 of Part III? How should "eligible counterparties" be defined for the purposes of entering into permitted derivatives?

In general ASCB does not believe that there should be specific requirements for the derivatives, more than perhaps that they should only be used for hedging purposes and should continue after an issuer event of default. Intra-group hedging should

definitely be permitted. The prohibition of intra-group hedging is unachievable. It should also be noted in this context that for a local currency market intra-group hedging is of particular importance and a prohibition would be detrimental for the covered bond market in such local currency market.

3. What are your views on the potential provisions on the management of cash flow mismatches suggested in subsection 4.3 of Part III? In particular:

a) for issuers, do cash flow mismatches between cover assets and covered bonds arise in your jurisdiction and/or transactions, and, if so, in which way? Are you able to describe a scenario for the timely repayment of the covered bonds? Do you plan for contingencies? Are such scenarios and contingencies disclosed to investors?

b) for investors, do you understand how such cash flow mismatches would be dealt with in practice? Would it be beneficial from your perspective to get systematic information about cash flow mismatches and how these would be managed?

ASCB agrees with ECBC

4. On the EBA's liquidity buffer recommendation:

a) should covered bond issuers hold a "liquidity buffer" to mitigate liquidity risk in the cover pool and, if so, in what circumstances?

b) should the buffer be calibrated to cover the cumulative net out-flows of the covered bond programme over a certain time frame? What length of time should be used as a time frame for calibration purposes?

c) what eligibility criteria should liquid/substitution assets meet to qualify for the purposes of this buffer?

The LCR-requirement should be enough. In addition, it is important to ensure that covered bond issuers do not have to hold liquidity buffer twice, one required through the LCR provisions and the other one based on covered bond legislation. If covered bond issuers have to hold a liquidity buffer for covered bonds, it should be deducted from the LCR liquidity buffer.

QUESTIONS – TRANSPARENCY REQUIREMENTS

1. What are your views on the current disclosure requirements set out in Article 129(7) of the CRR? If more detailed requirements were preferred, do you agree that issuers should disclose data on the credit, market and liquidity risk

characteristics to a more granular level? If so, what data and to what level of granularity?

ASCB believes that the disclosure requirements set out in article 129.7, preferably with further clarifications regarding transparency requirement on interest rate and currency risk, and the market initiatives which are being implemented right now, including the HTT, should be enough.

2. Should issuers disclose information on the counterparties involved in a covered bond programme and, if so, what type of information?

With respect to the counterparties, an approach disclosing the minimum required information is preferred. In the disclosures to investors, issuers should be invited to include the relevant counterparties involved in the covered bond programme as well as the applicable minimum credit ratings required for the relevant counterparties. Usually, the counterparty disclosure is already required to be disclosed in the covered bond prospectus pursuant to the prospectus regime.

3. How frequently should covered bond issuers be required to make disclosures to investors?

Quarterly

4. What are your views on the existing and prospective investor reporting templates prepared by industry bodies and referred to in section 5 of Part III? Would these templates:

a. be granular enough to enable investors to carry out a comprehensive risk analysis as recommended by the EBA? and

b. be sufficient without further legislative backing to deliver enhanced and consistent disclosure in European covered bond markets?

The level of, and amount of information required by an investor to carry out its assessment of the risk in its investment is not something that should be determined through regulations. That must be a fundamental part of the investors knowledge its work.

Nevertheless the prospective investor reporting templates prepared by industry bodies and referred to in section 5 of Part III could be considered sufficient to carry out comprehensive risk analysis without further legislative backing.

5. Should detailed disclosure requirements apply to all European covered bonds or only to those that would fall within the scope of the Prospectus regime?

Disclosure requirements, who are in line with requirements in art. 129.7 CRR, should apply to all European covered bonds.

6. Should the same level of disclosure standards apply pre- and post-insolvency/resolution of the issuer (except for those reporting items referring to the issuer itself)?

As investors may still hold the covered bonds after the issuer's insolvency, they need to get information on the quality of the cover assets. However, more information is not needed. If a covered bond issuer became insolvent, the investor would have to decide, either to stick to its investment or to sell the covered bonds. This decision would be driven by other factors than loan-level information on the cover pool, for instance by rating constraints. Moreover, the special public supervision of the covered bond business, which covers the oversight of cover assets, would still be in place.

7. In relation to covered bonds issued in third countries, what minimum level of disclosure should apply for European credit institutions investing in those instruments to benefit from preferential risk weights?

The minimum level of disclosure referred to article 129(7) of the Capital Requirements Regulation should apply.

Martin Rydin
Chairman ASCB