Prudential requirements for credit institutions and investment firms. Capital Requirements Regulation (CRR)

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The Commission presents a report on capital requirements for covered bonds.

Article 503 of Regulation (EU) No 575/2013 (the "CRR") on a number of items related to the regulatory capital treatment of covered bonds under the CRR, having regard to the recommendations made by the European Banking Authority ("EBA") bearing in mind the recommendation of the European Banking Authority (EBA).

To recall, **covered bonds** are debt obligations issued by credit institutions and secured on the back of a ring-fenced pool of assets (the "cover pool" or "cover assets") which bondholders have direct recourse to as preferred creditors. At the same time bondholders remain entitled to a claim against the issuing entity or an affiliated entity of the issuer as ordinary creditors for any residual amounts not fully settled with the liquidation of the cover assets.

This "dual recourse" mechanism contributes to making covered bond low-risk debt instruments. Credit institutions investing in covered bonds qualifying under Article 129 are allowed to hold lower levels of regulatory capital in relation to those instruments than would otherwise apply to senior unsecured bank debt. These comparative lower capital requirements are referred to by the CRR as "**preferential risk weights**".

The report discusses four points:

1) **Whether the preferential risk weights are adequate for qualifying covered bonds**: on the general question concerning the appropriateness of the preferential risk weights, the EBA considered that - due to the good historical default/loss performance of covered bonds in the EU, the dual recourse principle embedded in covered bond frameworks, the special public supervision and the existence of qualifying criteria in Article 129 of the CR - **the preferential risk weight treatment laid down in Article 129 of the CRR is, in principle, an appropriate prudential treatment.**

The Commission agrees with the EBA 's recommendation and submits the following:

- preferential risk weights should continue to be applied uniformly to all qualifying covered bonds, without distinction between asset classes or Member State of origination;
- the disclosure requirements towards investors forming part of the eligibility criteria in Article 129 of the CRR should not be changed at this juncture;
- at this stage, there should be **no changes to Article 129 of the CRR** taking into account the risk to which other creditors of the issuer institution are exposed.

In order to justify the continuation of the preferential prudential treatment, the EBA recommends more convergence between Member States' covered bond laws. The Commission intends to seek stakeholder feedback on the convenience and shape of an integrated EU covered bond framework through a dedicated **consultation paper** on covered bonds, as announced in the Capital Markets Green Paper on 18 February.

2) Whether preferential risk weights are appropriate for aircraft loans: having regard to the EBA's analysis and recommendation on this matter, **the Commission does not intend to make any proposals at this juncture to amend Article 129 of the CRR in order to include aircraft loans as eligible assets.** The Commission does, however, intend to **seek feedback from stakeholders** on the appropriate treatment for securities backed by loans that fund non-financial activities (which would include not only aircraft but also ship and SME loans).

3) Whether preferential risk weights are appropriate for guaranteed residential loans: the EBA concluded that it was appropriate to maintain residential loans secured by a guarantee within the scope of preferential risk weight treatment. It also deems it appropriate that, in addition to the qualifying criteria currently included in Article 129(1)(e) of the CRR, two additional criteria be considered for inclusion.

The Commission is of the view that it is **appropriate to continue treating qualifying guaranteed residential loans as eligible assets**. In relation to the additional criteria recommended by the EBA, the first one is already included in the eligibility requirements in Article 129 of the CRR. The Commission intends to seek stakeholder feedback on the second additional criterion.

4) Review of the Article 496 derogation: Article 496 of the CRR concerns a derogation from the 10% limit for senior units issued by French FCCs or equivalent securitisation instruments laid down in points (d) and (f) of Article 129(1) of the CRR which competent authorities may grant to credit institutions until 31 December 2017.

The EBA expresses overarching prudential concerns on the use of securitisation instruments as cover assets in excess of the 10% threshold. It considers it **appropriate that the derogation to the 10% limit for senior securitisation units be removed after 31 December 2017.**

The Commission will wait to **review stakeholder feedback to the consultation paper** to decide whether it would be appropriate to let Article 496 derogation lapse, make it permanent or replace it with a covered bond framework that may include provisions on covered bond structures backed by securitisation instruments.

The same applies to the matter of applying Article 496 derogation to other forms of covered bonds, specifically the pooled covered bond structures. The Commission intends to consult further with stakeholders on the appropriate legal and regulatory treatment of covered bond structures pooling cover assets originated or issued by other issuers. Structures involving covered bonds issued for intra-group funding purposes as currently used should be considered as part of this debate.