# Towards a pan-European covered bonds framework

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The European Parliament adopted by 543 votes to 99, with 56 abstentions, a resolution entitled 'Towards a pan-European covered bonds framework'.

**Reliable instruments**: Members stressed that **covered bonds have played a key role in the funding of credit institutions**, in particular during the financial crisis. Covered bonds (CBs) are instruments with a long-established track record of low default rates and reliable payments which help to finance around 20 % of European mortgages and accounted for more than EUR 2 000 billion of liabilities in Europe in 2015. Some 90 % of CBs worldwide are issued in nine European countries.

However, they **are not clearly defined** in EU law. This is why an EU-wide framework, based on the highest standards, should be established for covered bonds. However, harmonisation should respect the principle of subsidiarity and avoid a one-size-fits-all approach, as this could lead to a sharp decline in the diversity of financial products and have a negative effect on national markets.

**Proposed EU framework**: Parliament called for the adoption of an EU directive which clearly distinguishes between the two types of covered bonds currently in existence, namely:

- **Premium Covered Bonds (PCBs)** which do not fall below the standards currently set by Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms (CRR);
- **Ordinary Covered Bonds (OCBs)** which do not meet the requirements set out for PCBs but do not fall below the standards currently set by Directive 2014/91/EU of the European Parliament and of the Council relating to undertakings for collective investment in transferable securities (UCITS) as regards depository functions, remuneration policies and sanctions (UCITS Directive).

PCBs should continue to enjoy regulatory preference over OCBs and that OCBs should **enjoy regulatory preference** over other forms of collateralised debts.

**Secured notes**: in order to protect '**covered bond' label** (for both PCBs and OCBs), Parliament recommended that debt instruments covered by assets which are substantially more risky than government debt and mortgages (e.g. non-government backed infrastructure investments or credits to small and medium-sized enterprises (SMEs)) should not be labelled 'covered bonds' but, possibly, '**European Secured Notes**' (ESNs).

The Commission shall include in the directive principles of a legal framework for European Secure Notes (ESNs) such as dual recourse, special public supervision, bankruptcy remoteness and transparency requirements. Member States are called upon to integrate these principles into their national law and **insolvency procedures**.

According to Members, a sound legal framework for ESNs could help ESNs to finance riskier activities such as SME credits, consumer credits or infrastructure investments which lack government guarantees.

**Common principles**: Parliament called on the Commission to include in the definition of premium covered bonds, ordinary covered bonds, European secure notes, a common set of principles that may be achieve throughout the life of this issued instrument, independent of potential preferential treatment.

These principles may include:

- PCBs, OCBs and ESNs should be fully backed by a cover **pool of assets**;
- national law should ensure **dual recourse**, i.e. the investor has: (i) a claim on the issuer of the debt instrument equal to the full payment obligations; (ii) an equivalent priority claim on the cover pool assets in the event of the issuer's default.

In addition, the duties and powers of the competent authority and the special administrator in the event of the issuer's insolvency or resolution must be clearly defined.

To avoid unnecessary disruptions in smoothly working covered bond markets, Parliament suggested defining covered bonds **building closely on Article 129 of the CRR**.

Parliament also:

- called on the Commission to empower the European Supervisory Authorities (ESAs) to evaluate compliance with the criteria for PCBs, OCBs and ESNs with the aim of supplementing or even replacing the lists with an authoritative list of compliant PCBs, OCBs and ESN regimes at European level;
- called on the EBA to issue recommendations for PCB, OCB and ESN regimes on eligibility criteria for assets and to provide the necessary guidelines for the establishment of the special public supervisory and administrative framework;
- recommended **removing market access barriers** for issuers in developing covered bond markets outside the European Economic Area (EEA) be removed by providing equitable treatment to covered bonds from issuers in third countries, provided their legal, institutional and supervisory environment passes a thorough equivalence assessment.

**Transparency**: lastly, in order to support **market transparency**, Members supported the development of EBA recommendations for market standards and guidelines on best practices and encouraged voluntary convergence along these lines.