# Exposures in the form of covered bonds

2018/0042(COD) - 12/03/2018 - Legislative proposal

PURPOSE: to amend the requirements for the prudential treatment of covered bonds in order to promote the development of covered bond markets.

PROPOSED ACT: Regulation of the European Parliament and of the Council.

ROLE OF THE EUROPEAN PARLIAMENT: the European Parliament decides in accordance with the ordinary legislative procedure and on an equal footing with the Council.

BACKGROUND: this proposal for a Regulation amending Regulation (EU) No 575/2013 (Captial Requirements Regulation – CRR) is part of a package of measures to deepen the Capital Markets Union (CMU), together with the Communication "Completing Capital Markets Union by 2019 – time to accelerate delivery".

**Covered bonds** are financial instruments that are generally issued by banks to fund the economy. They facilitate the financing of mortgage and public sector loans, thereby supporting lending more broadly. Covered bonds fared well during the financial crisis and proved to be a **reliable and stable funding** source at a time as other funding channels dried up.

However, **diverse rules** across Member States affect the credit strength of those instruments. In addition, covered bonds markets are unevenly developed across the Single Market. While they are very important in some Member States, they are less developed in others.

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.

The Commission considers that 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;
- increase cross-border flows of capital and investment which would provide investors with a wider and safer range of investment opportunities, contribute to financial stability and help finance the real economy.

The framework consists of a Directive on definitions and standards for covered bonds and a Regulation amending the Capital Requirements Regulation (CRR) – the two instruments should be seen as a single package.

IMPACT ASSESSMENT: of the four options considered, the option chosen is that of **minimum harmonisation based on national regimes**. It is based on the recommendations made in the 2016 European Banking Authority (EBA) report, with the exception of a few deviations.

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.

CONTENT: this proposed Regulation will mainly amend Article 129 of Regulation (EU) No 575/2013 (Capital Requirements Regulation (CRR)) with the aim of strengthening the conditions for granting preferential capital treatment by **adding further requirements**.

The amendments build on the current prudential treatment but **add requirements on minimum overcollateralisation and substitution assets**.

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