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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
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To:	Mr Jeppe TRANHOLM-MIKKELSEN, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2017) 5562 final
Subject:	COMMISSION DELEGATED REGULATION (EU) …/... of 11.8.2017 amending Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards the waiver on own funds requirements for certain covered bonds

Delegations will find attached document C(2017) 5562 final.

Encl.: C(2017) 5562 final

EUROPEAN
COMMISSION

Brussels, 11.8.2017
C(2017) 5562 final

COMMISSION DELEGATED REGULATION (EU) …/...

of 11.8.2017

amending Regulation (EU) No 575/2013 of the European Parliament and of the Council as regards the waiver on own funds requirements for certain covered bonds

(Text with EEA relevance)

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EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

1.1. General background

Article 129(1) of the Regulation (EU) No 575/2013 (the "Regulation",) grants preferential treatment to covered bonds collateralized by senior units issued by French Fonds Communs de Titrisation or equivalent securitization entities, securitising residential (point (d)) or commercial (point (f)) property exposures, provided that certain conditions are met:

(a) they qualify for credit quality step 1 under the credit risk rules in the Regulation;

(b) their amount does not exceed 10% of the nominal amount of the outstanding covered bonds issued;

(c) they are backed by residential/commercial mortgage loans eligible under Article 129 of the Regulation.

However, Article 496(1) of the Regulation waives the second condition (10% limit) until 31 December 2017 provided that:

(a) the securitised property was originated by a member of the same consolidated group of which the issuer of the covered bond is a member; and

(b) a member of the same group retains the whole first loss tranche of the senior units.

This derogation is typically referred to as the “MBS waiver” (as for Mortgage Backed Securities). It is used for the purpose of including senior units of securitized residential (RMBs) or commercial property (CMBs) exposures in the cover pool. In addition, in at least one Member State (Denmark), it has been used for intra-group covered bond structures, i.e. covered bonds issued by an entity in the group and transferred into the cover pool of the covered bond program issued by another entity within the same group to final investors ("pooled covered bond structures").

1.2. Legal and economic background to this Delegated Act

Article 503(4) of the Regulation requires the Commission to review this waiver in order to determine whether it is still appropriate. If so, the Commission may adopt delegated acts to make it permanent.

There are currently only four national covered bond frameworks that allow the inclusion of RMBSs and/or CMBSs in cover pools (France, Ireland, Italy and Luxembourg). Available market data suggests that very few outstanding covered bond programmes include RMBS/CMBS units in their cover pools.

Concerning the pooled covered bond structures, the waiver in Article 496 of the Regulation has only been granted by the Danish authorities to Nykredit Group, one of Denmark's largest banks specialising in mortgage lending and a leading issuer of covered bonds in Denmark.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In order to review the appropriateness of the derogation set out in Article 496 of the Regulation, the Commission consulted the European Banking Authority (the "EBA"). In the 2014 Report on Covered Bonds, the EBA recommended not to extend the waiver due to a number of prudential concerns, notably the added legal and operational complexity resulting from the double layer structure provided by the covered bonds and the tranche of securitisation instruments backing those and the potential conflicting requirements on transparency and due diligence between the covered bond programme and the underlying securitisation instruments.[1]

At the same time, the EBA noted that in at least one Member State, intra-group transfers of collateral, i.e. covered bonds issued by an entity in the group and transferred into the cover pool of the covered bond program of another entity within the same group, have so far been based on Article 496(1) (a) and (b) of the Regulation. While assessing the use of Article 496(1) of the Regulation for such purposes was outside the scope of the EBA report, the EBA nonetheless recommended that the Commission further considers whether a specific provision could be introduced in Article 129 of the Regulation making it possible to allow specific intra-group transfers of compliant covered bonds with the Regulation as eligible collateral. The EBA added that, from a prudential perspective, no additional risk appears to be introduced by such a provision, provided that the entity is sufficiently integrated into the group.

Based on the EBA report, the Commission consulted the Expert Group on Banking, Payments and Insurance (the "EGBPI") and asked whether they considered that the waivers should be permanently extended, and if yes, should both waivers, the one on the RMBSs/CMBSs and the one on pooled covered bond structures, be extended or only one of them?

The Member States shared in general the views on the EBA, thus opposing the extension of the waiver regarding RMBSs/CMBSs. Several were not opposed to extend the waiver with regards to pooled covered bond structures as currently used by the Danish Nykredit Group, considering the views from the EBA of no additional risk being added and, as such, supported an extension of this use of the waiver. Admittedly, only nine Member States provided comments.

Following the initial consultation, it was assessed that the mandate set out in Article 503(4) of the Regulation can only be used to make the waiver permanent, not amending the scope. To do that, a legislative proposal would be necessary, which would not be possible to amend before the exemption expires.

To address the prudential concerns related to the current scope of the waiver without unduly undermining legitimate business models based on the waiver in its current form, the EGBPI was consulted again, asked about their views on two complementary and linked actions: The adoption of a delegated act making the waiver permanent and the proposal to amend Article 496(1) of the Regulation in the future covered bond framework that was announced by the Commission as part of the Capital Markets Union Mid Term Review. The amendments are supposed to allow the future use of pooled covered bond structures and will eliminate the use

[1] EBA (2014)"EBA report on EU covered bond frameworks and capital treatment". See in particular Recommendation EU COM 2 - C: Derogation on RMBS/CMBS in cover pools, p.128.

of RMBS/CMBS as cover assets above the current limit defined in Article 129(1)(d)(ii) and (f)(ii) of the Regulation, in accordance with the EBA recommendation and the views expressed by the Member States in the initial consultation.

At the EGBPI meeting 9 June 2017 the Member States in general supported the suggested solution as a way of both addressing the prudential concerns regarding the use of the waiver regarding RMBS/CMBS as cover assets and finding an immediate solution to the credit institutions relying on the current waiver with regards to pooled covered bonds structures. The necessity to find a permanent solution excluding the use of the waiver with regards to RMBS/CMBS when addressing the issue in the context of future covered bonds harmonisation was however expressed by several Member States.

As a reassurance to the Member States having indicated concerns on the permanent extension on all elements on the waiver the recitals clearly state that the waiver may be reassessed in the context of a future covered bonds framework.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

As the only purpose of the delegated act is repealing the expiration date of the waiver, the delegated act has been kept simple only deleting the date to make the waiver permanent.

4. TIME-TABLE AND PROCEDURE

The application date of the delegated act is set to be 1 January 2018 to secure the continuous use of the waiver.

In order to accommodate the necessary application date, it is opportune to launch the inter-service consultation so as to permit adoption by the College in July.

Following adoption, the delegated act will be subject to scrutiny by the European Parliament and Council.

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THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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[2], and in particular Article 503(4) thereof,

Whereas:

(1) Article 496 of Regulation (EU) No 575/2013 allows competent authorities to waive, for certain covered bonds and until 31 December 2017, the threshold of 10 % referred to in Article 129(1)(d)(ii) of that Regulation and Article 129(1)(f)(ii) of that Regulation.

(2) Article 503(4) of Regulation (EU) No 575/2013 obliges the Commission to review the appropriateness of that possibility for the competent authorities and to decide whether that possibility should be made permanent. The Commission requested the European Banking Authority to provide technical advice on that issue. That request resulted in the "Report on EU Covered Bond Frameworks and Capital Treatment". The Commission used that report to further assess the supervisory and regulatory arrangements applicable to covered bonds and subsequently presented to the European Parliament and the Council a report on Article 503 of Regulation (EU) No 575/2013.

(3) It appeared from that report that only a limited number of national covered bond frameworks allow the inclusion of residential or commercial mortgage backed securities or intra-group pooled covered bond structures. However, since some institutions rely in their business models on the use of the waiver granted by competent authorities, it is appropriate for reasons of legal certainty to allow the competent authorities to extend the waiver referred to in Article 496(1) of Regulation (EU) No 575/2013 beyond the date mentioned in that provision. Article 496(1) of Regulation (EU) No 575/2013 should therefore be amended to repeal the date mentioned in that provision, with the understanding however that the possibility for competent authorities to grant a waiver may have to be reassessed in the context of a future covered bonds framework.

[2] OJ L 176, 27.6.2013, p. 1.

(4) For reasons of legal certainty, it is appropriate to provide for a permanent derogation from the date following the expiry of the current derogation,

(5)

HAS ADOPTED THIS REGULATION:

Article 1

In Article 496(1) of Regulation (EU) No 575/2013, the introductory sentence is replaced by the following:

> "Competent authorities may waive in full or in part the 10 % limit for senior units issued by French Fonds Communs de Créances or by securitisation entities which are equivalent to French Fonds Communs de Créances laid down in points (d) and (f) of Article 129(1), provided that both of the following conditions are fulfilled:".

Article 2

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 1 January 2018.

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

Done at Brussels, 11.8.2017

For the Commission
The President
Jean-Claude JUNCKER