# Issue of covered bonds and covered bond public supervision

2018/0043(COD) - 12/03/2018 - Legislative proposal

PURPOSE: to harmonise national regimes in order to ensure a smooth and continuous development of well-functioning covered bond markets in the Union and to limit potential risks and vulnerabilities to financial stability.

PROPOSED ACT: Directive 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 Directive 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". The package includes this proposal, as well as a proposal to facilitate the cross-border distribution of investment funds, a proposal on the law applicable to the third-party effects of assignments of claims and a Communication on the applicable law to the proprietary effects of transactions in securities.

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.

This proposal seeks to amend Article 129 of Regulation (EU) No 575/2013 (CRR Regulation).

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 Directive will specify the core elements of covered bonds and provide a common definition as a consistent and sufficiently detailed point of reference for prudential regulation purposes, applicable across financial sectors.

The Directive defines covered bonds as debt obligations issued by credit institutions and secured against a ring-fenced pool of assets to which bondholders have direct recourse as preferred creditors.

The Directive, in continuity with this tradition, only allows credit institutions to issue covered bonds. This is coherent with the inherent nature of the instrument which is to provide funding for loans, and granting loans on a large scale is a credit institution's business. In addition, credit institutions have the necessary knowledge and management capability of credit risk in relation to the loans in the cover pool and they are subject to sound capital requirements which contribute to underpin the investor protection as laid down in the dual recourse mechanism.

The proposal also establishes:

- a more articulated series of structural requirements of coverage bonds: (i) dual recourse gives investors a double claim on both the issuer of covered bonds and the assets in the cover pool; (ii) bankruptcy protection; (iii) ensure the quality of the cover pool, in particular ensuring that only high-quality assets are used as collateral; (iv) liquidity and transparency requirements; (v) regulation of the structures to ensure they are not unnecessarily complex or opaque; (vi) the possibility for Member States to require a cover pool monitor;
- covered bond public supervision: in order to protect investors, the proposed Directive harmonises the components of such supervision and specifies the tasks and responsibilities of the national competent authorities performing it. Member States should be able to appoint different competent authorities;
- rules authorising the use of the European covered bonds label: the proposal allows credit institutions to use the specific 'European Covered Bonds' label when issuing covered bonds. The use of the label would make it easier for investors to assess the quality of the covered bonds. It should however be facultative and Member States should be able to keep their own national denominations and labelling framework in place in parallel to the 'European Covered Bonds' label, provided that these comply with the requirements set out in this Directive;
- publication obligations of competent authorities performing the covered bond public supervision: administrative penalties and other administrative measures laid down by Member States should satisfy certain essential requirements in relation to the addressees of those penalties or measures, the criteria to be taken into account in their application, the publication obligations of competent

authorities performing the covered bond public supervision, the power to impose penalties and the level of administrative pecuniary penalties that may be imposed.