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THE EUROPEAN PARLIAMENT

THE COUNCIL

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LEGISLATIVE ACTS AND OTHER INSTRUMENTS

Subject: REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE
COUNCIL amending Regulation (EU) No 575/2013 as regards exposures
in the form of covered bonds

REGULATION (EU) 2019/...
OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL

of ...

amending Regulation (EU) No 575/2013
as regards exposures in the form of covered bonds

(Text with EEA relevance)

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Article 114 thereof,

Having regard to the proposal from the European Commission,

After transmission of the draft legislative act to the national parliaments,

Having regard to the opinion of the European Central Bank¹,

Having regard to the opinion of the European Economic and Social Committee²,

Acting in accordance with the ordinary legislative procedure³,

¹ OJ C 382, 23.10.2018, p. 2.

² OJ C 367, 10.10.2018, p. 56.

³ Position of the European Parliament of 18 April 2019 (not yet published in the Official Journal) and decision of the Council of

Whereas:

- (1) Article 129 of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹ grants preferential treatment to covered bonds under certain conditions. Directive (EU) 2019/... of the European Parliament and of the Council²⁺ specifies the core elements of covered bonds and provides for a common definition of covered bonds.

¹ 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 and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).

² Directive (EU) 2019/... of the European Parliament and of the Council of ... on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (OJ L ..., ..., p. ...).

⁺ OP: Please insert the number of Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU and complete footnote.

- (2) On 20 December 2013, the Commission requested the European Supervisory Authority (European Banking Authority) ('EBA'), established by Regulation (EU) No 1093/2010 of the European Parliament and of the Council¹, to provide an opinion on the appropriateness of the risk weights for covered bonds set out in Article 129 of Regulation (EU) No 575/2013. According to EBA's opinion of 1 July 2014, the preferential risk weight treatment provided for in Regulation (EU) No 575/2013 constitutes, in principle, appropriate prudential treatment. However, EBA recommended that further consideration be given to complementing the eligibility requirements for the preferential risk weight treatment to cover, at a minimum, the areas of liquidity risk mitigation and overcollateralisation, the role of competent authorities, and the further development of existing requirements on disclosure to investors.
- (3) In the light of EBA's opinion, it is appropriate to adopt additional requirements for covered bonds, thereby strengthening the quality of covered bonds eligible for favourable capital treatment under Regulation (EU) No 575/2013.

¹ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

- (4) Competent authorities may partially waive the application of the requirement for exposures to credit institutions within the cover pool to qualify for credit quality step 1 and allow exposures of up to a maximum of 10 % of the nominal amount of outstanding covered bonds of the issuing institution to qualify for credit quality step 2 instead. However, such a partial waiver applies only after prior consultation of EBA and only where significant potential concentration problems resulting from the application of the credit quality step 1 requirement in the Member States concerned can be documented. As the requirements for exposures to qualify for credit quality step 1 as made available by external credit assessment institutions have become increasingly difficult to comply with in most Member States, both within and outside the euro area, the application of such a partial waiver was considered to be necessary by those Member States which host the largest covered bonds markets. To simplify the use of exposures to credit institutions as collateral for covered bonds, and in order to address potential concentration problems, it is necessary to amend Regulation (EU) No 575/2013 by establishing a rule allowing exposures to credit institutions up to a maximum of 10 % of the nominal amount of outstanding covered bonds of the issuing institution to qualify for credit quality step 2 instead of credit quality step 1 without a requirement to consult EBA. It is necessary to allow the use of credit quality step 3 for short-term deposits and derivatives in specific Member States where compliance with the requirement for credit quality step 1 or 2 would be too difficult. Competent authorities designated pursuant to Directive (EU) 2019/...⁺ should be able, after consulting EBA, to allow the use of credit quality step 3 for derivative contracts in order to address potential concentration problems.

⁺ OP: Please insert the number of Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

- (5) Loans secured by senior units issued by French *Fonds Communs de Titrisation* or issued by equivalent entities that securitise residential property or commercial immovable property exposures are eligible assets which can be used as collateral for covered bonds, up to a maximum of 10 % of the nominal amount of the outstanding issue of covered bonds (the ‘10 % threshold’). However, Article 496 of Regulation (EU) No 575/2013 allows competent authorities to waive the 10 % threshold. Furthermore, Article 503(4) of that Regulation requires the Commission to review the appropriateness of the derogation that allows competent authorities to waive the 10 % threshold. On 22 December 2013, the Commission requested EBA to provide an opinion in that regard. In its opinion, EBA stated that the use of senior units issued by French *Fonds Communs de Titrisation* or issued by equivalent entities that securitise residential property or commercial immovable property exposures as collateral would raise prudential concerns due to the double layered structure of a covered bond programme backed by securitisation units and would thereby lead to insufficient transparency regarding the credit quality of the cover pool. Consequently, EBA recommended that the derogation from the 10 % threshold for senior units currently provided for in Article 496 of that Regulation be removed after 31 December 2017.
- (6) Only a limited number of national covered bond frameworks allow the inclusion in the cover pool of residential or commercial mortgage-backed securities. The use of such structures is decreasing and is considered to add unnecessary complexity to covered bond programmes. It is thus appropriate to eliminate the use of such structures as eligible assets altogether.

- (7) Covered bonds issued within intragroup pooled covered bond structures which comply with Regulation (EU) No 575/2013 have also been used as eligible collateral. Intragroup pooled covered bond structures do not pose additional risks from a prudential perspective because they do not raise the same complexity issues as the use of loans secured by senior units issued by French *Fonds Communs de Titrisation* or issued by equivalent entities that securitise residential property or commercial immovable property exposures. According to EBA's opinion, collateralisation of covered bonds by intragroup pooled covered bond structures should be allowed without limits related to the amount of outstanding covered bonds of the issuing credit institution. The requirement to apply the limit of 15 % or 10 % in relation to exposures to credit institutions in intragroup pooled covered bond structures should therefore be removed. Those intragroup pooled covered bond structures are regulated by Directive (EU) 2019/...⁺.
- (8) The valuation principles for immovable property collateralising covered bonds apply to covered bonds in order for those bonds to meet the requirements for preferential treatment. The eligibility requirements for assets that serve as collateral for covered bonds relate to the general quality features that ensure the robustness of the cover pool and should therefore be laid down in Directive (EU) 2019/...⁺. Accordingly, the provisions on the valuation methodology should be laid down in that Directive and the regulatory technical standards on the assessment of the mortgage lending value should not apply in respect of those eligibility criteria for covered bonds.

⁺ OP: Please insert the number of Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

- (9) Loan-to-value limits (LTV limits) are a necessary part of ensuring the credit quality of the covered bonds. Article 129(1) of Regulation (EU) No 575/2013 establishes LTV limits for mortgages and maritime liens on ships but does not specify how those limits are to be applied. This could lead to uncertainty. LTV limits should apply as soft coverage limits. This means that while there are no limits to the size of an underlying loan, such a loan can act as collateral only within the LTV limits for the assets. LTV limits determine the percentage portion of the loan that contributes to the coverage requirement for liabilities. It is therefore appropriate to specify that LTV limits determine the portion of the loan contributing to the coverage of the covered bond.
- (10) To ensure greater clarity, LTV limits should apply throughout the entire maturity of the loan. The actual LTV limits should not change but should remain at 80 % of the value of residential property for residential loans, at 60 % of the value of commercial immovable property for commercial loans with the possibility of an increase to 70 % of that value, and at 60 % of the value of ships. Commercial immovable property should be understood in line with the general understanding of that type of property being ‘non-residential’ immovable property, including when held by not-for-profit organisations.

- (11) In order to further enhance the quality of the covered bonds that receive preferential treatment, such preferential treatment should be subject to a minimum level of overcollateralisation, meaning a level of collateral exceeding the coverage requirements referred to in Directive (EU) 2019/...⁺. Such a requirement would mitigate the most relevant risks arising in the case of the issuer's insolvency or resolution. A Member State's decision to apply a higher minimum level of overcollateralisation to covered bonds issued by credit institutions located in its territory should not prevent credit institutions from investing in other covered bonds with a lower minimum level of overcollateralisation that comply with this Regulation and from benefitting from its provisions.
- (12) Credit institutions investing in covered bonds are required to be provided with certain information regarding those covered bonds on at least a semi-annual basis. Transparency requirements are an indispensable part of covered bonds ensuring a uniform disclosure level and allowing investors to perform the necessary risk assessment, enhancing comparability, transparency and market stability. It is therefore appropriate to ensure that transparency requirements apply to all covered bonds by laying down those requirements in Directive (EU) 2019/...⁺. Accordingly, such requirements should be removed from Regulation (EU) No 575/2013.

⁺ OP: Please insert the number of Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

- (13) Covered bonds are long-term funding instruments, and are therefore issued with a scheduled maturity of several years. It is therefore necessary to ensure that covered bonds issued before 31 December 2007 or before ... [the date of application of this amending Regulation] are not affected by this Regulation. In order to achieve that objective, covered bonds issued before 31 December 2007 should remain exempt from the requirements of Regulation (EU) No 575/2013 with respect to eligible assets, overcollateralisation and substitution assets. In addition, other covered bonds that comply with Regulation (EU) No 575/2013 and are issued before ... [the date of application of this amending Regulation] should be exempt from the requirements on overcollateralisation and substitution assets and should continue to be eligible for the preferential treatment set out in that Regulation until their maturity.
- (14) This Regulation should be applied in conjunction with the provisions of national law transposing Directive (EU) 2019/...⁺. In order to ensure the consistent application of the new framework establishing the structural features of the issue of covered bonds and the amended requirements for preferential treatment, the application of this Regulation should be deferred to coincide with the date from which Member States are to apply the provisions of national law transposing that Directive.
- (15) Regulation (EU) No 575/2013 should therefore be amended accordingly,

HAVE ADOPTED THIS REGULATION:

⁺ OP: Please insert the number of Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

Article 1
Amendments to Regulation (EU) No 575/2013

Regulation (EU) No 575/2013 is amended as follows:

(1) Article 129 is amended as follows:

(a) paragraph 1 is amended as follows:

(i) the first subparagraph is amended as follows:

– the introductory part is replaced by the following:

“To be eligible for the preferential treatment set out in paragraphs 4 and 5 of this Article, covered bonds as defined in point (1) of Article 3 of Directive (EU) 2019/... of the European Parliament and of the Council⁺ shall meet the requirements set out in paragraphs 3, 3a and 3b of this Article and shall be collateralised by any of the following eligible assets:

* Directive (EU) 2019/... of the European Parliament and of the Council of... on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (OJ L ..., ..., p. ...).”;

⁺ OJ: Please insert the number, date and publication reference of Directive (EU) 2019/... of the European Parliament and of the Council of ... on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

- point (c) is replaced by the following:
 - "(c) exposures to credit institutions that qualify for credit quality step 1 or credit quality step 2, or exposures to credit institutions that qualify for credit quality step 3 where those exposures are in the form of:
 - (i) short-term deposits with an original maturity not exceeding 100 days, where used to meet the cover pool liquidity buffer requirement of Article 16 of Directive (EU) 2019/...⁺; or
 - (ii) derivative contracts that meet the requirements of Article 11(1) of that Directive, where permitted by the competent authorities;"
- point (d) is replaced by the following:
 - "(d) loans secured by residential property up to the lesser of the principal amount of the liens that are combined with any prior liens and 80 % of the value of the pledged properties;"

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

– point (f) is replaced by the following:

“(f) loans secured by commercial immovable property up to the lesser of the principal amount of the liens that are combined with any prior liens and 60 % of the value of the pledged properties. Loans secured by commercial immovable property are eligible where the loan-to-value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders’ claim meets the legal certainty requirements set out in Chapter 4. The bondholders’ claim shall take priority over all other claims on the collateral;”;

(ii) the second subparagraph is replaced by the following:

“For the purposes of paragraph 1a, exposures caused by the transmission and management of the payments of the obligors of loans secured by pledged properties of debt securities or by the transmission and management of liquidation proceeds in respect of such loans shall not be comprised in calculating the limits referred to in that paragraph.”;

(iii) the third subparagraph is deleted;

(b) the following paragraphs are inserted:

“1a. For the purposes of point (c) of the first subparagraph of paragraph 1, the following shall apply:

- (a) for exposures to credit institutions that qualify for credit quality step 1, the exposure shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution;
- (b) for exposures to credit institutions that qualify for credit quality step 2, the exposure shall not exceed 10 % of the nominal amount of outstanding covered bonds of the issuing credit institution;
- (c) for exposures to credit institutions that qualify for credit quality step 3 that take the form of short-term deposits, as referred to in point (c)(i) of the first subparagraph of paragraph 1, or the form of derivative contracts, as referred to in point (c)(ii) of the first subparagraph of paragraph 1, the total exposure shall not exceed 8 % of the nominal amount of outstanding covered bonds of the issuing credit institution; the competent authorities designated pursuant to Article 18(2) of Directive (EU) 2019/...⁺ may, after consulting EBA, allow exposures to credit institutions that qualify for credit quality step 3 in the form of derivative contracts, provided that significant potential concentration problems in the Member States concerned due to the application of credit quality step 1 and 2 requirements referred to in this paragraph can be documented;

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

- (d) the total exposure to credit institutions that qualify for credit quality step 1, 2 or 3 shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution and the total exposure to credit institutions that qualify for credit quality step 2 or 3 shall not exceed 10 % of the nominal amount of outstanding covered bonds of the issuing credit institution.
- 1b. Paragraph 1a shall not apply to the use of covered bonds as eligible collateral as permitted pursuant to Article 8 of Directive (EU) 2019/...⁺.
- 1c. For the purposes of point (d) of the first subparagraph of paragraph 1, the limit of 80 % shall apply on a loan-by-loan basis, shall determine the portion of the loan contributing to the coverage of liabilities attached to the covered bond, and shall apply throughout the entire maturity of the loan.
- 1d. For the purposes of points (f) and (g) of the first subparagraph of paragraph 1, the limits of 60 or 70 % shall apply on a loan-by-loan basis, shall determine the portion of the loan contributing to the coverage of liabilities attached to the covered bond and shall apply throughout the entire maturity of the loan.”;

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

(c) paragraph 3 is replaced by the following:

“3. For immovable property and ships collateralising covered bonds that comply with this Regulation, the requirements set out in Article 208 shall be met. The monitoring of property values in accordance with point (a) of Article 208(3) shall be carried out frequently and at least annually for all immovable property and ships.”;

(d) the following paragraphs are inserted:

“3a. In addition to being collateralised by the eligible assets listed in paragraph 1, covered bonds shall be subject to a minimum level of 5 % of overcollateralisation as defined in point (14) of Article 3 of Directive (EU) 2019/...⁺.

For the purposes of the first subparagraph, the total nominal amount of all cover assets as defined in point (4) of Article 3 of that Directive shall be at least of the same value as the total nominal amount of outstanding covered bonds (‘nominal principle’), and shall consist of eligible assets as set out in paragraph 1.

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

Member States may set a lower minimum level of overcollateralisation for covered bonds or authorise their competent authorities to set such a level, provided that:

- (a) either the calculation of overcollateralisation is based on a formal approach where the underlying risk of the assets is taken into account, or the valuation of the assets is subject to the mortgage lending value; and
- (b) the minimum level of overcollateralisation is not lower than 2 %, based on the nominal principle referred to in Article 15(6) and (7) of Directive (EU) 2019/...⁺.

The assets contributing to a minimum level of overcollateralisation shall not be subject to the limits on exposure size set out in paragraph 1a and shall not count towards those limits.

- 3b. Eligible assets listed in paragraph 1 may be included in the cover pool as substitution assets as defined in point (13) of Article 3 of Directive (EU) 2019/...⁺, subject to the limits on credit quality and exposure size set out in paragraphs 1 and 1a of this Article.”;

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

(e) paragraphs 6 and 7 are replaced by the following:

“6. Covered bonds issued before 31 December 2007 shall not be subject to the requirements laid down in paragraphs 1, 1a, 3, 3a and 3b. They shall be eligible for preferential treatment under paragraphs 4 and 5 until their maturity.

7. Covered bonds issued before... [the date of application of this amending Regulation] that comply with the requirements laid down in this Regulation as applicable at the date of their issue shall not be subject to the requirements laid down in paragraphs 3a and 3b. They shall be eligible for preferential treatment under paragraphs 4 and 5 until their maturity.”;

(2) in point (a) of Article 416(2), point (ii) is replaced by the following:

“(ii) they are covered bonds as defined in point (1) Article 3 of Directive (EU) 2019/...⁺ other than those referred to in point (i) of this point;”;

(3) in Article 425, paragraph 1 is replaced by the following:

“1. Institutions shall report their liquidity inflows. Liquidity inflows shall be capped at 75 % of liquidity outflows. Institutions may exempt liquidity inflows from deposits placed with other institutions that qualify for the treatment set out in Article 113(6) or (7) of this Regulation from that cap.

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

Institutions may exempt liquidity inflows from monies due from borrowers and bond investors where those inflows are related to mortgage lending funded by bonds eligible for the treatment set out in Article 129(4), (5) or (6) of this Regulation or by covered bonds as defined in point (1) of Article 3 of Directive (EU) 2019/...⁺ from that cap. Institutions may exempt inflows from promotional loans that the institutions have passed through. Subject to the prior approval of the competent authority responsible for supervision on an individual basis, the institution may fully or partially exempt inflows where the liquidity provider is a parent or subsidiary institution of the institution, a parent or subsidiary investment firm of the institution or another subsidiary of the same parent institution or parent investment firm or is related to the institution as set out in Article 22(7) of Directive 2013/34/EU.”;

(4) in point (b) of Article 427(1), point (x) is replaced by the following:

“(x) liabilities resulting from securities issued that qualify for the treatment set out in Article 129(4) or (5) of this Regulation or from covered bonds as defined in point (1) of Article 3 of Directive (EU) 2019/...⁺”;

(5) in point (h) of Article 428(1), point (iii) is replaced by the following:

“(iii) match funded (pass-through) via bonds eligible for the treatment set out in Article 129(4) or (5) of this Regulation or via covered bonds as defined in point (1) of Article 3 of Directive (EU) 2019/...⁺”;

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.

(6) Article 496 is deleted;

(7) in point 6 of Annex III, point (c) is replaced by the following:

“(c) they are covered bonds as defined in point (1) of Article 3 of Directive (EU) 2019/...⁺ other than those referred to in point (b) of this point.”.

Article 2

Entry into force and application

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 ... [30 months from the date of entry into force of this Regulation].

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

Done at ...,

For the European Parliament

The President

For the Council

The President

⁺ OP: Please insert the number of the Directive (EU) 2019/... of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU.