



Council of the European Union
General Secretariat

Brussels, 04 November 2025

Interinstitutional files:
2025/0825 (COD)
2025/0826 (COD)

WK 14817/2025 INIT

LIMITE

EF
ECOFIN
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WORKING DOCUMENT

From: General Secretariat of the Council
To: Working Party on Financial Services and the Banking Union (Securitisation)
Financial Services Attachés

Subject: Securitisation Review: non-paper from Germany on Recalibrating Securitisations in view of Covered Bond. Agenda item no. 2 of the WP Meeting on 7 November 2025

WK 14817/2025 INIT

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Recalibrating Securitisations in view of Covered Bonds

The green and digital transformation will require additional investments of 1 trillion EUR per year by 2030 (Noyer, 2024). Recalibrating the prudential requirements for securitisation is an important step to enable banks to provide the level of financing needed for Europe to meet this challenge. To achieve this, the recalibration of the capital requirement should remove overly conservative elements in the current calibration of the regulatory framework and ensure a risk adequate capitalisation. In other words: the calibration of the prudential requirements has to follow the material risk inherent in the position.

Making sure that the recalibration does not merely lead to distributive effects but provides actual added value, the calibration needs to fit also into the wider ecosystem of prudential requirements, notably in regard to covered bonds. Prior to 2018/2019, the minimum risk weight for securitisations was 7% and that of covered bonds 10%; today, it is equally 10% for both types of instruments. In order to increase risk sensitivity for securitisations, COM proposes to introduce a risk sensitive floor so that for certain securitisations the minimum risk weights could be reduced down to 5% (current PCY proposal is 6%).

In calibrating the capital requirements for securitisation, we note the following points:

- **Covered Bonds are not riskier than securitisations:** Covered bonds are no risk transfer-instruments (collateralised full recourse instruments) and have to meet specific quality, structural, and supervisory requirements under Art. 129 CRR in conjunction with the Covered Bond Directive (cover pool, overcollateralization, valuation/legal requirements, special supervision). Indeed, covered bonds have never defaulted in the past. While certain securitisations may achieve a partly comparable risk profile depending on the structure, credit enhancement and granularity, these instruments are far more complex than covered bonds.
- **Covered bonds serve liquidity purposes, securitisation may serve liquidity and capital purposes:** Securitisations are far more heterogeneous compared to covered bonds both in terms of underlying assets and structure. Covered bonds are mainly used for liquidity purposes, including via the Liquidity Coverage Ratio (LCR) and central bank eligibility (even as “own use”/retained covered bonds). By contrast, securitisations may be used for capital purposes (synthetic securitisation) as well as liquidity purposes (true sale securitisation).
- **Covered bonds and securitisations in part rely on the same type of underlying exposure:** Covered bonds and securitisations intersect in terms of underlying exposures especially around mortgages on (residential) real estate. Discriminating RW for securitisations (RMBS) positively may give rise to market movements from covered bonds cover pools to securitisation underlying exposures.
- **An imbalance in risk weights could shift investor preferences:** The more RW for securitisations at the high quality-end are lowered and the wider the potential application of such lower risk weights, the higher the risk that investors might shift their preferences towards senior tranches of securitizations due to potentially lower capital requirements. Any dampening effect on covered bonds would go counter the promotion of this instrument on the international stage (Basel-recognition of lower CB-RW, EBA-recommended third-country equivalence regime). A growth of the EU capital market will only be achieved, if securitisation harnesses its own full potential, but does so without tapping into the existing covered bond market.