Brussels, 6th January 2016

EACB Answer to the

Public consultation on Covered bonds in the European Union

January 2016

The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 31 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4,200 locally operating banks and 68,000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 205 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 78 million members and 860,000 employees and have a total average market share of about 20%.

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Introduction

The EACB welcomes the opportunity to participate in the discussion around the development of the EU framework for covered bonds. In particular, the EACB believes that cooperative banks with their networks of regional and retail banks could benefit from an approach that allows SME and household credit to continue being provided at a local level by improving wholesale market finance of those assets through improved secured funding instruments.

Responses to the consultation Questions

Part I : QUESTIONS – COVERED BOND MARKETS: ECONOMIC ANALYSIS

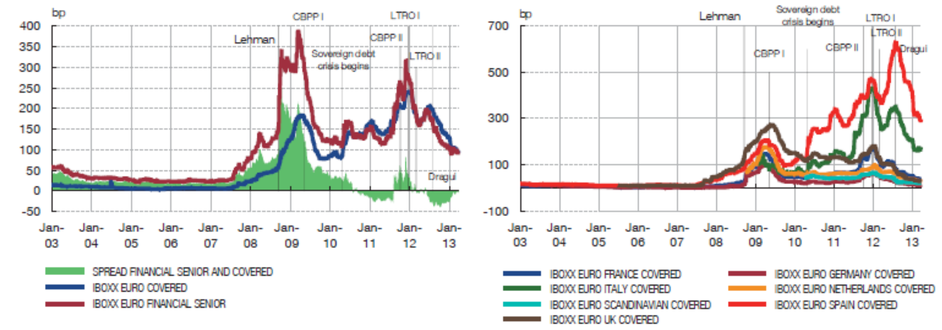
1. **In your opinion, did pricing conditions in European covered bond markets converge and diverge before and after 2007, respectively? If so, what where the key drivers of this convergence/divergence? Please, provide evidence to support your view.**

Yes, before 2007 covered bonds were seen as "rate products" dominated by German Pfandbrief. After 2008 they became credit products as investors became concerned about the quality of the pools and the jurisdictions of the issuer, plus the tenor mis-matched between the assets and the liabilities. Broadly speaking, the fact that market participants started to perceive differently 'core' and 'periphery' countries in the field of sovereign debt led to the same distinction between 'core' and 'periphery' covered bond issuers. Correlation between sovereign bonds and covered bonds significantly increased during the most acute phases of the sovereign crisis, and has since 2012 decreased. This has also been the case for other credit asset classes, such as senior bonds.
Indicatively, we refer to the following chart obtained from Bank of Spain document "Covered Bond: The renaissance of and old acquaintance"[1].

We consider that the response of European Covered Bond Council (ECBC) to the EC Consultation Document on covered bonds[2] in the EU provides a comprehensive analysis in that regard**.**

[1]http://www.bde.es/f/webbde/GAP/Secciones/Publicaciones/InformesBoletinesRevistas/RevistaEstabilidadFinanciera/13/Mayo/Fic/ref2013244.pdf
[2]http://www.hypo.org/DocShareNoFrame/docs/1/LABKGPGDDEOKEDJODOCPABHHPDWN9DBDBYTE4Q/EMF/Docs/DLS/2016-00002.pdf

SENIOR DEBT AND COVERED BOND SPREADS FOR DIFFERENT EUROPEAN COUNTRIES (a) CHART 3



SOURCES: Iboxx, Barclays.

a "Lehman": Lehman Brothers files for Bankruptcy; "Sovereign debt crisis begins": Greece seeks financial support; "Dragui": Whatever it takes speech.

2. **Was pricing divergence an evidence of fragmentation between covered bonds from different Member States? Do you agree with the reasons for market fragmentation described in section 2.1 of Part I? Were there any other reasons?**

Indeed, there seems to be a correlation with the country of origin of each issuer. However, it is our view that the fragmentation came from the sovereign debt markets and not from within the covered bond market. This correlation shows that the covered bonds could not be fully dissociated from the sovereign crisis.
In general, we agree on the general rationale behind section 2.1 of the Consultation Document.

We consider that the response of European Covered Bond Council (ECBC) to the EC Consultation Document on covered bonds in the EU provides a comprehensive analysis in that regard.

3. **In your view, is there any evidence of pricing differentiation/fragmentation between covered bond issuers on the basis of size and systemic importance, as well as their geographical location?**

The members of EACB believe that this was also the case. In the view of our members it has both been motivated by 'too-big-to-fail' market considerations and by considerations of country (and redenomination) risks. It seems that systematic covered bond issuers in periphery countries had an easier (and cheaper) access to the market in stressed times (i.e. sovereign crisis) even if the credit metrics of those banks as well as of their cover pools were similar or worse that those of smaller issuers'.
We consider that the response of European Covered Bond Council (ECBC) to the EC Consultation Document on covered bonds in the EU provides a comprehensive analysis in that regard.

4. **Is there an appropriate alignment in the regulatory treatment between covered bonds and other collateralised instruments? If there is a misalignment, could you illustrate what differences in regulatory treatment you deem as inappropriate and why?**

As acknowledged by the EC in it's consultation paper the crisis has illustrated that covered bonds have been much more resilient that other collateralised instruments including securitisations. However, it is difficult to assess whether the reason lies in misalignments in regulatory treatment or in different market perceptions (USA Residential Mortgage Backed Securities (RMBS) debacle, lack of transparency, leveraged nature of securitisation tranches, lack of confidence in rating agencies approach, e.t.c.).

In any case covered bonds have a long tradition and a quality branding. Other collateralised instruments are not regarded as having the same regulatory rigidity. We believe that this should remain unchanged. This will also give issuers and structurers a certain level of flexibility to create products which would not fit in to the covered bond legislation but would offer useful funding alternatives.

5. **Are operational costs for covered bond issuance lower than for other collateralised instruments? Can you quantify the respective costs, even if only approximately?**

The EACB considers that operational costs are higher for those collateralised instruments that, unlike covered bonds, require the creation and maintenance of ad-hoc vehicles as it is the case for securitisations. The leveraged nature of tranche-structures in securitisations is also a reason for their higher complexity. The ratings-agencies approach to securitisation is also, in the EACB view, more complex and requires the rating of several tranches which are collateralised by the same asset pool.
Also on this point we consider that the response of European Covered Bond Council (ECBC) to the EC Consultation Document on covered bonds in the EU provides a good analysis in that regard.

It is difficult to provide exact numbers and accurate estimates of the respective costs at this moment.

6. **Are there significant legal or practical obstacles to:**

a) **cross-border investment in covered bond markets within the Union and in third countries and**
b) **issuance of covered bonds on the back of multi-jurisdictional cover pools? Please provide evidence to support your views.**

The members of EACB do not see any obstacle to cross-border investment in covered bond markets within the Union and in third countries. This is evident by the degree in which issuers and investors from different European countries are mixed in primary and secondary markets. However, it cannot be denied that during stress times for sovereign credit markets, ‘core’ investors restricted their holdings and participation in ‘periphery’ bond issuers.
When it comes to point b) it needs to be ensured that all local laws grant the same level of ring-fence structure in case of an insolvency of the issuer. We see this requirement as a major legal/practical obstacle.

PART II- QUESTIONS – LEGAL FRAMEWORK AND INTEGRATION

1. **Would a more integrated "EU covered bond framework" based on sound principles and best market practices be able to deliver the benefits suggested in section 2 of Part II? Are there any advantages or disadvantages to this initiative other than those described in section 2 of Part II?**

The EACB considers that a more integrated covered bond market would be in our view beneficial to the aims of the Capital Market Union (CMU) project. The advantages and disadvantages are well described in section 2 of Part II of the Consultation.

The EACB also considers it is of utmost importance that any adopted framework maintains an appropriate level of flexibility to avoid disrupting existing covered bond structures and markets, which have already proven their efficiency. At the same time, it should be ensured that there is no emphasis on one covered bond model over the others, as one model which functions well in the specific environment of one country may not necessarily perform well in another country. In this context it should be borne in mind that these differences stem in particular from divergent legislation (in particular insolvency laws), various market conditions (different levels of significance of buy-to-let sector, state subsidies on loans for low income families etc.) and varied banking sectors (centralised banking groups, cooperative groups with regional banks). For example, the "assets on the balance-sheet" model is appropriate for centralised banks, but not for cooperative groups with regional independent banks. Consequently, favouring one model over another would undermine the overall efficiency of this refinancing instrument and imply additional costs that would compromise the financing of the real economy.

2. **In your view, are market-led initiatives such as the "Covered Bond Label" sufficient to better integrate covered bond markets? Should they be complemented with legislative measures at Union or Member State level?**

The EACB believes that the participants to the Covered Bond market (including issuers, investors and regulators) are well aware of the importance of achieving more integration. We are especially positive towards a harmonisation of areas such as public supervision, dual recourse, coverage calculation, arrangements in the case of issuer insolvency. In addition, we regard a harmonised standard for issuer transparency obligations as sensible in order to establish a single binding market standard for the benefit of investors. In this context EBA´s best practices are a good initiative and can further improve the functioning of the market and its harmonisation. The EACB favours a subsidiarity-based approach as the most effective way to encourage greater convergence for two (2) reasons:

a) The causes of divergence in the European Covered Market during the financial crisis did not lie in structural flaws of the national legal frameworks, but instead in the market fears about redenomination risk and about the breaking of the European Monetary Union (EMU). Those fears also affected many asset classes - some even to a greater extent. Moreover, even though national Covered Bond frameworks show differences, we believe that market participants, and more specifically investors, have a great degree of understanding of such differences, and deep and wide legal and economic research is available in the market that allows acquiring a high level of knowledge of the features of every issuer´s national framework.

b) Both issuers and investors could benefit from more similar national frameworks, but Member States are better placed to understand each market´s specificities. We should not forget that even if Covered Bonds –as securities- can be compared with each other, their Cover Pool is legally dependent on the respective mortgage markets, laws and national courts.

   Investors themselves would be negatively surprised if a hard approach (i.e. an EU product regulation for an integrated framework) was adopted. The main reasons would be:

- National frameworks' differences are in important issues caused by different structural features of the mortgage markets of each country. It would not make sense to make every country´s legislation to converge in one single framework because civil law, market uses, consumer behaviour, and industry´s structures are fundamentally different.
- Investors would become very anxious about their 'legacy book', because 'old' (but outstanding) Covered Bonds would have a very different legal framework and hence

huge differences of treatment for different investors could arise. Relevant market disruption could emerge for the Covered Bond asset class.
- National authorities of Member States are well aware of the degree of divergence of their national frameworks and some of them are already in the process of improving convergence within EBA´s guidelines.

Therefore, most of the EACB members strongly prefer for "Option 1" of section 3 of Part II of the Consultation as the best approach for creating a common EU framework via a high quality principle-based approach taking into account national specificities - at least at this juncture. In any case, it is essential that any adopted framework maintains appropriate flexibility to avoid disrupting existing covered bond structures and markets, which have already proven their viability and well-functioning. The European Commission itself in its CMU Action Plan expressly notes that these national regimes are functioning in general well and that the use of market-led initiatives to increase convergence whilst maintaining the different national frameworks already in place.

Our members could potentially also support an alternative option, which would combine proposed options 1 and 2, as follows:

1. New secondary legislation in selected fields currently covered by UCITS 52(4) and Article 129 CRR – namely, public supervision, over-collateralisation, liquidity-risk management, asset segregation and minimum transparency.
2. Voluntary convergence via EU non-legislative recommendations/best practice guidelines/market initiatives in other areas such as the cover pool administration post issuer default, dual recourse, eligibility criteria, mixed cover pools, LTVs and valuations, stress testing, transparency (Covered Bond Label, Harmonised Transparency Template) and soft bullet/conditional pass-through structures.

This would allow some degree of flexibility which is important, while introducing certain legislative measures to set minimum standards in order to better protect the covered bond market.

Moreover, we would like to highlight that, as mentioned in the consultation paper an additional legal framework (the 29th regime) could lead to further fragmentation of the covered bond market.

3. **Should the Commission pursue a policy of further legal/regulatory convergence in relation to covered bonds as a means to enhance standards and promote market integration? If so, which of the options suggested in section 3 of Part II should the Commission follow to that end and why?**

Please refer to our answer to question 2 above.

4. **Specifically, if the Commission were to issue a recommendation to Member States as suggested in section 3 of Part II would you consider that sufficient or should it be complemented by other measures (both legislative and non-legislative)? (see question 8 below)**

Indeed, the EACB believes that issuing recommendations could be the best way forward.

5. **On the suggested list of high level elements for an EU covered bond framework:**

   a) is the list sufficiently comprehensive or should it include any other items?

b) should the Commission seek to develop all the elements or a subset of them?

c) if only a subset, should the Commission give priority to the target areas identified by the EBA Report: (i) special public supervision of cover pools and issuers; (ii) characteristics of the cover pool; and (iii) transparency?

Please refer to our answer to the questions above.

6. **What are your views on the merits described under section 3 of Part II of using different legal instruments to develop an EU covered bond framework? In particular, would it be desirable to harmonise through a directive some of the legal features of covered bonds and requirements applicable to them under Member States' laws? If it were proposed, how could a 29th Regime on covered bonds be designed to provide an attractive alternative to existing national laws?**

Please refer to our answers above. Moreover, we would advise against the confusion and legal uncertainty that could arise from having not only different national frameworks, but also national frameworks AND a new European framework. We doubt it is something desirable and practicable.

7. **How should an EU covered bond framework deal with legacy transactions?**

Ideally, an EU covered bond framework should avoid any legacy issues and existing covered bonds should be covered by the existing regulations until the maturity date. Establishment of new cover pools with grandfathering schemes for earlier issues would be both cost-intensive and detrimental to bond series' liquidity.

8. **Would you view a combination of recommendations to Member States (Option 1) and targeted harmonisation of certain minimum standards (Option 2) as desirable and sufficiently flexible? If so, what should be the subject of each option?**

Please refer to our answers above.

PART III:

QUESTION – COVERED BOND DEFINITION
What are your views on the proposals set out in section 1 of Part III for a "new legal definition" of covered bonds to replace Article 52(4) of the UCITS Directive?
As explained in Q 2 above most of the EACB members support "Option 1" of section 3 of Part II of the Consultation as the best approach for creating a common EU framework, while they could also see an alternative approach which would combine proposed "Options 1"and "Option 2".
Having said that, in general we agree on those proposals. However, the EACB does not support a simple abandonment of the -UCITS-compliant covered bond framework leaving only current CRR-compliant covered bonds as the protected framework going forward. This could be disruptive for some covered bonds systems – for instance for some specialised credit institutions systems.

QUESTIONS – ISSUER MODELS AND LICENSING REQUIREMENTS. ROLES OF SPVs
1. Should the current licensing system be simplified to require a "one-off" authorisation only for all covered bond issuers based on common high level standards? What specific prudential requirements (that is, in addition to those in CRR and CRD) could be applied as a condition for granting a covered bond issuer license?

The EACB believes that the EU Framework should recognise all existing issuer models and any new authorisation system should not be detrimental to existing models.

2. If the covered bond issuer is subject to a one-off covered bond-specific licence, what would be the additional benefits of requiring that each covered bond programme be subject to prior authorisation as well? Alternatively, would pre or post notification to the competent authority of the programme and of each issue within or amendment to the programme suffice? How should "covered bond programme" be defined for these purposes?
The members of EACB do not believe that additional requirements for issuing covered bonds are necessary. In any case, the EU Framework should recognise all existing issuer models and any new authorisation system should not be detrimental to existing models.

3. Should the Framework explicitly allow the use of SPVs to ring-fence cover pools of assets backing issues of covered bonds? What specific requirements should apply to these SPVs?
Yes, it should. SPVs allow different credit institutions to transfer cover assets. On top of legal reasons (enhancing the quality and legal reliability of the priority claim), these structures are specifically interesting for smaller issuers such as cooperative banks, because they allow regional financial institutions to better pool assets and hence more efficiently arrange the issuance of Covered Bonds, helping the finance of the real, local economy through the use of SPVs´ based Covered Bonds as a means to connect borrowers and capital markets.

4. Regarding the use of pooled covered bonds structures and SPVs:
a) would it be desirable for an EU covered Bond Framework to allow the use of these structures and why? What legal structures are used in your jurisdiction to pool assets from different lenders or issuers?
As stated above, SPVs and pooled covered bonds structures allow different credit institutions to transfer cover assets. On top of legal reasons (enhancing the quality and legal reliability of the priority claim), these structures are specifically interesting for smaller issuers such as cooperative banks, because they allow regional financial institutions to better pool assets and hence more efficiently arrange the issuance of Covered Bonds, helping the finance of the real, local economy through the use of SPVs´ based Covered Bonds as a means to connect borrowers and capital markets.

b) which approach would be the most suitable for pooling assets across borders?
The EACB considers that all existing methods (SPVs and pooled structures) should be expressly permitted.

c) where the issuer of pooled covered bonds is an SPV, should this issuer be regulated as a credit institution or as some other form of legal entity?
The EACB does not see the need for such requirement, due to the very restricted nature of the financial activities developed by such SPVs.

QUESTIONS – ON-GOING SUPERVISION AND MONITORING OF COVER POOLS (PRE-INSOLVENCY)
1. In your view, would it be desirable for an EU covered bond Framework to set common duties and powers on competent authorities for the supervision of covered bond programmes and issuers? What specific duties and powers should be included in the Framework and/or EBA or ESMA Guidelines?

The EACB members consider that a set of common supervisory duties and powers for national supervisory authorities would be a positive step in promoting consistent practice and supervision by competent authorities within national frameworks. However, such a common supervisory framework should be based on general principles and describe these duties and powers only in high-level terms, rather than in more specific functions which may not fit properly with some local regimes.

2. What are your views on the proposals set out in subsection 2.2 of Part III on the appointment of and legal regime for cover pool monitors?
The EACB members consider that the appointment of cover pool monitors may have advantages in the sense of increasing independence and regulatory reporting. However, it should be avoided that such requirements go as far as making Covered Bonds´ issuance too much regulated and/or impose any kind of prior authorisation requirements, because one of the main advantages of the asset class is the agility that issuers are given to quickly adapt to market conditions by choosing the momentum for Covered Bond issuance.

QUESTION – COVERED BONDS AND THE SSM
Should the ECB have specific supervisory powers, and if so which ones, in relation to covered bond issuance of credit institutions falling within the scope of the SSM?
The EACB does not see the need for extending the supervisory powers of the ECB/SSM. National supervision should continue performing its role in covered bond programmes.

QUESTION – DUAL RECOURSE PRINCIPLE
Do you agree with the proposed formulation for "dual recourse"?
EACB agrees that dual recourse principle is essential in any common European covered bond framework.

However, derivative counterparties (hedging imbalances between the covered bonds and the loans), which, typically, have the same legal position as the covered bond holders do not seem to have been taken into account when formulating the proposed definition. In particular, upon the issuer's insolvency or resolution, the bondholders have a priority right to the assets constituting the statutory security for the covered notes conferred by the applicable law. The issuer's counterparties to derivative transactions entered into in order to hedge against risks relating to the covered notes and cover pool assets and recorded in the register and the providers of any liquidity loans borrowed by the bankruptcy estate enjoy the same preferential treatment as bondholders in the issuer’s insolvency or resolution. These counterparties and lenders should have an equal right with the bondholders to payments from the cover pool.

Furthermore, our members agree with the definition of "full recourse". To the extent that if claims of bondholders in relation to covered notes are not met out of the cover pool, the residual claims of the bondholders should at least rank *pari passu* with the unsecured and unsubordinated obligations of the issuer.

QUESTIONS – SEGREGATION OF THE COVER ASSETS
1. Are there any advantages to using an SPV as an additional segregation mechanism at issuance? Are cover assets typically transferred to the SPV at issuance via legal or equitable assignment?
We do not see the need for requiring an obligatory use of SPVs given that segregation is already ensured in all jurisdictions, with or without SPVs structures.

2. In your jurisdiction, what legal and practical steps are required in order to segregate effectively the cover assets from the issuer's insolvent estate or in resolution? Would it be necessary to serve a notification to each borrower of the issuer? Until notification is served, what is the legal status of any proceeds of the cover assets which may be paid directly into the insolvent estate or to the issuer in resolution?
This information should be obtained from the individual countries.

QUESTIONS – LEGAL FORM AND SUPERVISION OF THE COVER POOL
1. Should the cover pool be incorporated as a regulated entity? In that case, what type?
The members of EACB do not consider such a measure necessary or appropriate as it would be too burdensome making the structure inefficient. We fear that any such requirement could even prove damaging for the development of the European Covered Bond market.

2. Who should be the supervisory authority for these purposes, the competent authority or the resolution authority?
See previous answer.

QUESTIONS – SPECIAL ADMINISTRATOR OF THE COVER POOL
1. What are your views on the proposals set out in subsection 3.3 of Part III on the appointment and legal regime for a cover pool special administrator?
Although the EACB members recognise the advantages of improving convergence in the cover pool administration, we would advise against a too restrictive regime for cover pool administration, which is a duty that in several European jurisdictions is carried out efficiently by the issuers themselves. We also believe that transparency (to the market, to rating agencies, to regulators, to investors) is enough to maintain a well-functioning Covered Bond market.

2. Should the special administrator be obliged to report regularly to the relevant supervisory authority? Should the content and regulatory of such reporting be the same as for the issuer?
See previous answer.

QUESTIONS – RANKING OF COVER POOL LIABILITIES
1. Do you agree with the suggested ranking for cover pool liabilities? Is the wording proposed in subsection 3.3 of Part III sufficient to define clearly the claims that may arise, avoid confusion between claims and prevent claims in an unreasonable amount from arising?
All liabilities (i.e. liabilities of the cover pool/SPV owed to services providers and liabilities relating to the existence and maintenance of the cover pool/SPV) should rank in priority to or *pari passu* with the covered bond holders (depending on the covered bond model). The same stands for hedging transactions entered into to mitigate rate/currency exposure: These should be permitted to rank in priority to, or, as applicable, *pari passu* with, the covered bond liabilities.

2. Is it possible to define hedging activity better and, if so, how?
The EACB does not see the need for more precision in the definition of hedging – at least at this moment.

QUESTIONS – INTERACTION BETWEEN COVER POOL AND ISSUER IN INSOLVENCY/RESOLUTION

1. Are current provisions in EU law sufficient to deliver effective protection for boldholders in a resolution scenario involving covered bonds? In particular, is it sufficiently clear:

a) how the cover pool would be segregated under each possible resolution or recovery scenario of the issuer?

b) how the full recourse against the issuer would take effect if the issuer is in resolution and is not placed subsequently into liquidation?

c) what procedural steps should be followed in resolution and by whom in order to make effective the dual recourse mechanism?

The members of EACB believe that EU and national laws already provide for a sufficient framework for effectively protecting bondholders.

2. Should the Framework provide for a cut-off mechanism as suggested in subsection 3.4 of Part III? In particular, should such a cut-off mechanism:

a) preclude the closure of insolvency or resolution before possible residual claims from the covered bondholders against the issuer or the insolvent estate have been identified and quantified?

b) set out clear and objective requirements on the valuation of the cover pool and the timing for such valuation?

c) extinguish the residual claim on the estate or the successor credit institutions after sufficient assets have been segregated for the benefit of covered bondholders at the outset of the resolution or insolvency proceedings?

d) give specific powers and duties to the resolution authority and, if so, what should those consist in?

See previous answer.

QUESTIONS – RESIDENTIAL AND COMMERCIAL LOANS

1. Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets? Should certain riskier residential or commercial loans (ie buy-to-let mortgages; second home loans; loans to real estate developers; etc.) be excluded from the cover pool or permitted subject to stricter criteria?

Yes, the members of EACB agree with the proposed definitions.

Moreover, the EACB members consider that all the loans within the proposed definitions should be included in the cover pool. There are several reasons for this, to name a few:

- It is doubtful whether a particular category of loans is inherently riskier than others. That is something that can depend on the specific market´s features of each country, and something that, moreover, can change over time. For example, second home loans are clear and exhibit no materially higher risks than other loans provided the guarantees and civil liability of the borrower.
- Transparency is key in this field. Investors should have enough information to know the exact composition of the cover pool, including different categories of loans. It is then up to them to decide whether those assets are riskier, whether even if they are, they can contribute to the diversification of the Cover pool and whether each Cover Pool (once its composition is disclosed) deserves a different assessment of risk and consequently, a different pricing.

2. In relation to mortgage loans:

a) what are your views on the proposed requirements on "perfection of security" and "first ranking mortgage"? Is registration of the security a requirement for perfection in your jurisdiction?

The EACB does consider that the registration of the security should be a requirement for defining a "mortgage".
At the same time, "first ranking mortgages" should not become a requirement. The purpose of the loan and the ranking of the loan are less important as long as there are sufficient assets in the cover pool, inter alia based on LTV indicators. Furthermore, the mortgage should be legally enforceable independently of ranking, i.e. each bank holding a lien on a property can initiate the sale of the property independently from other entities holding a lien on the property.

b) is the enforceability of mortgages in the different Member States equivalent or should there be additional requirements to ensure their equivalence?
Currently there are divergent enforcement situations throughout the Eurozone and it is embedded in the legal framework for each country. This is a difficult "nut to crack" to ensure "equivalence". If an attempt is made to "crack that nut" this framework should make it possible to enforce the mortgage within a reasonable time frame if the borrower is unable to meet its payment obligations. Enforcement must be possible without the institution incurring any significant financial or other obligations as a condition for or a result of such enforcement**.**

c) are minimum standards for mortgage rights in third countries necessary?
Yes, minimum standards for mortgage rights could facilitate mortgage business in third countries.

3. In relation to LTVs:
a) what are your views on the proposals set out in subsection 4.1 of Part III on minimum LTVs?
The EACB in general agrees with the proposals, but would like to point out the following:

- LTV limits should be calculated on what is often described in the industry as 'soft' limits instead of 'hard' ones. That is, LTVs requirements should not restrict loans with higher LTVs to belong to the Cover Pool. Otherwise, the Covered Bond framework would create a potent and negative pro-cyclicality, reducing coverage levels more than necessary when bigger capacity is needed and in general introducing a high degree of volatility in the coverage levels calculations.
- One method of implementing 'soft' LTV limits is by only calculating a discounted value as a contribution to coverage. If the LTV is above the maximum limit, only the excess should be excluded from the collateralisation coverage levels, but should not, neither at the origin nor during the life of the loan, make the loan ineligible for the collateralisation coverage level calculation.
- Another method of implementing 'soft' LTV limits is on the basis of eligibility of loans at inception which, in combination with mandatory OC in the cover pool in the form of capital requirements for the loans, accounts for the coverage for the investors throughout the lifetime of the loan. In such a model, the ongoing monitoring of LTV determines the changes to the mandatory OC, e.g. an increase in LTVs triggers an increase in mandatory OC.
- The need to measure property values should be commensurate with the costs and administrative burden for the industry, especially when cover pools are comprised of very granular, small and diversified properties. In particular, we believe that alternative appraisal methods, such as statistical valuations (without a physical and asset-by-asset assessment) should be allowed.
- Privilege for any excess over the LTV cap should be limited to the collateralisation coverage level as determined by the relevant law.

b) in the case of insured properties, should higher LTV limits be allowed if the insurance cover meets certain requirements and, if so, what should such

requirements be? In what other cases should higher LTV limits be allowed? Could loan-to-income requirements be used to replace or complement LTV limits?
Introducing more ratios such as loan-to-income requirement is not the right tool in our view. It would make the Covered Bond framework much more complex, and the coverage levels much more volatile, while the calculations for such ratios are not universal and are prone to different methods of assessment.

c) should there be an additional average LTV eligibility limit at portfolio level?
No, it should be up to investors to assess average LTV as an additional metric of each Cover Pool.

d) with the advent of a Binding Technical Standard defining Mortgage Lending Value, is it appropriate to apply this for eligibility in all cover pools across the Union as a prudent measurement?
No, valuation for Cover Pools´assets should not be required to comply with such requirements.

e) should LTV limits be used to determine: eligibility (loan in/out) of loans at inception? Eligibility (loan in/out) of loans on an ongoing basis? Should they instead be used to simply determine contribution to coverage? A combination of the above?
See question 3.a) above. LTV limits should not determine eligibility, but simply determine contribution to coverage.

4. In relation to the valuation of cover assets:
a) how frequently should the value be updated and in which way (revaluation, update of the initial valuation, and in which way)?
The monitoring of property values and subsequent revaluation where necessary for the purposes of covered bond funding should be aligned with the requirements of Art. 208(3) of the Capital Requirements Regulation for the purposes of assessing credit risk. Any misalignment of requirements for these two purposes would be extremely burdensome for credit institutions to manage in practice.

b) what criteria should be applied to (i) the valuer and (ii) the valuation process to ensure that they meet the transparency and independence principles set out in the first and second subparagraphs of Article 229(1) CRR?
The need to measure property values should commensurate with the costs and administrative burden for the industry, especially when cover pools are comprised of very granular, small and diversified properties. In particular, we believe that alternative appraisal methods, such as statistical valuations (without a physical and asset-by-asset assessment) should be allowed.

5. Should the Framework adopt the definition of "non-peforming exposures" as set out in the EBA's draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-performing Exposures8?
"Non-performing" should remain a simple and easy to measure concept, e.g. "90+ days arrears".
The Consultation Document further considers a proposal to exclude non-performing mortgages from the cover pool. On this proposal it is important to duly take into account the difference between universal credit institutions and specialised credit institutions.
A universal credit institute would be able replace non-performing mortgages inside the cover pool with performing mortgages from outside the cover pool. This does not imply extra costs, but it increases asset encumbrance as non-performing assets are replaced by performing assets from outside the cover pool. A specialised credit institution would not be able to replace non-performing mortgages with performing mortgages from outside the cover pool, since no such mortgages exists. The specialised credit institution covers the economic risk from the non-performing mortgages by its loan impairment charges which reduce its capital and,

consequently, the amount of securities serving as over collateralisation; consequently, fully covering the economic risk from non-performing mortgages.

6. In light of the EBA's prudential concerns in relation to the use of RMBSs and/or CMBSs in cover pools, should the Framework exclude these assets completely from qualifying as cover assets (including, for these purposes, as substitution assets) or should they be allowed only subject to strict criteria and within the 10% limit currently permitted under Article 129 of the CRR? What is the added value and practical uses of RMBS/CMBS as collateral in your jurisdiction/issuer?
The EACB would like to note that it supports the EBA's conclusions concerning specific intra-group transfers of CRR-compliant covered bonds as eligible collateral, cf. footnote 106 of the EBA's Report.

QUESTIONS – PUBLIC SECTOR LOANS
1. What are your views on the proposals for public sector loans as cover assets set out in subsection 4.1 of Part III?
No answer for the moment.

2. What eligibility requirements in terms of validity and enforceability should apply to the guarantee granted by the relevant public sector entity?
No answer for the moment.

QUESTIONS – OTHER ASSET CLASSES: AIRCRAFT, SHIP AND SME LOANS
1. Should the Framework exclude aircraft, ship and SME loans from cover pools or should they be allowed only subject to strict criteria and limits? If so, what criteria and limits should be applied?
Most of our members consider that these should be allowed in their own separate pools, not in a mixed pool.

2. In relation to SME loans, is it possible to identify a category of "prime" SME loans as a potential eligible asset class for cover pools?
SME loans are already allowed within the cover pools, provided they are mortgage guaranteed. Some members consider that other SME loans without mortgage guarantee could also be included, but this would pose difficulties (LTV calculations, …) and could potentially harm the "Covered bond" label. According to our knowledge, investors would prefer an amendment of the relevant covered bond law allowing such SME loans to become collateral for "Dual-recourse" bonds, but outside the "Covered Bond" framework in order to avoid product "dilution". This means that covered bond methodologies could be used in connection with such SME loans but the end product should not be called covered bond in this case. With this in mind, the European Secured Note (ESN)[3] seems to be a more suitable funding tool for the variety of SME loans across the European Union.

QUESTIONS – MIXED POOLS AND LIMITS ON EXPOSURES
1. Do you agree that mixed-asset cover pools should be allowed?
Yes, they should be allowed.

[3]http://intranet.hypo.org/docs/1/GOLJCGEAJKPDFMHGBIKDGMNMPDW19DBDTYTE4Q/EMF/Docs/DLS/2015-00072.pdf

2. What are your views on the proposed limits on specific assets and concentration of exposures? Should any other limits or requirements apply?
No more limits or requirements should apply. Transparency is enough for investors to assess such credit metrics of the Cover pool and the market should remain open to diversity in terms of Cover pool composition and concentration, this reflecting diverse national markets and business models.

QUESTIONS – COVERAGE REQUIREMENT
1. Which option should be preferred for the Framework to formulate the coverage requirement and why?
a) a general requirement along the lines of Article 52(4) of the UCITS Directive, amended to include the wording suggested by the EBA;
b) a nominal coverage;
c) a net-present value coverage;
d) a net-present value coverage under stress; or
e) any other or a combination of the some or all of the above.
We would favour a measure that is as simple as possible (i.e. a "nominal coverage" calculation or net-present value).

2. If the coverage requirement were formulated as net-present value coverage under stress, should the stress tests be specified in any form in the Framework or ESMA/EBA regulatory guidelines? If so, what specific stress tests should be required and why?
No answer for the moment.

3. Should derivatives entered into in relation to the cover pool be taken into account for the purpose of determining the coverage requirement? If so, what valuation metric should be used for these purposes?
Yes, derivatives should be taken into account. Derivatives used for hedging purposes must be accounted for in the coverage requirement as their value ensures the balance between the value of cover assets and issued covered bonds.

4. What exposures to credit institutions within the pool should be taken into account to determine the coverage requirement and why?
In order to avoid exposure one should use one-sided CSAs or exchange-traded derivatives.

QUESTIONS – OVERCOLLATERALISATION
1. Should a quantitative mandatory minimum OC level be set in the Framework? If so, what should that level be and should it be the same for all types of covered bonds?
In general, a minimum OC requirement that is calculated as a percentage of issued covered bonds or the loan portfolio is too simple as it doesn't take account of the actual risk in the loan portfolio (not risk based approach). It would require the same OC level no matter if the loan portfolio consists of loans with 40 or 80 percent LTV.

An example could be the minimum OC as prescribed by the LCR delegated acts, albeit that this will introduce volatility around key rating triggers, e.g. loss of AA- rating. It would also result in minimum OC rising from 2% to 7% (the latter when covered bonds shift from level 1 to level 2 liquid assets. Another example could be a minimum OC which is calculated based on capital requirements and which represents what is needed to cover for losses in stress scenarios.

However, in any case, the level should obviously be dependent on the type of covered bond as well as on the implementation of the different building blocks the Framework is supposed to cover.

2. If a mandatory minimum OC level were set in the Framework, should there be exceptions to the requirement? (for example where the issuer applies a precise "match funding model" or where certain targeted liquidity and market risk mitigation measures are used – see subsection 4.3 of Part III)
In general, institutions applying a precise "match funding model" or equivalent model mitigating liquidity and market risk should be excepted from a mandatory minimum OC requirement meant to mitigate such risks
3. Should the Framework set a maximum level of permitted OC? If so, when and at what level?
No. Asset encumbrance concerns should be best tackled through other prudential regulation measures (MREL, …).

4. Should the Framework provide for the treatment of voluntary OC in the event of insolvency/resolution of the issuer?
Voluntary OC is vital to obtain a sufficient rating of the covered bonds. In the event of insolvency/resolution, "voluntary" OC has to be protected.

QUESTIONS – MARKET AND LIQUIDITY RISKS
1. In your view, are OC levels adequate to mitigate market and liquidity risks in the absence of targeted measures such as those described in subsection 4.3 of Part III?
High OC levels can reflect asset-liability mismatches, i.e. market and liquidity risks. However, a requirement of a minimum OC level may punish systems that eliminate or minimise asset-liability mismatch risks. Other tools or measures (e.g. match funding, soft bullet or other maturity extension structures, and derivatives for interest rate or currency risk) may address the same risks.

2. Should the Framework lay down specific requirements on the use of derivatives as suggested in subsection 4,3 of Part III? How should "eligible counterparties" be defined for the purposes of entering into permitted derivatives?
In principle the EACB agrees with the definitions of eligible counterparties, but the intra-group hedging should be allowed.

3. What are your views on the potential provisions on the management of cashflow mismatches suggested in subsection 4.3 of Part III? In particular:
a) for issuers, do cashflow mismatches between cover assets and covered bonds arise in your jurisdiction and/or transactions, and, if so, in which way? Are you able to describe a scenario for the timely repayment of the covered bonds? Do you plan for contingencies? Are such scenarios and contingencies disclosed to investors?
Yes, Covered bond maturities tend to be shorter than the assets maturities within the Cover Pool. This information is disclosed to investors.

b) for investors, do you understand how such cashflow mismatches would be dealt with in practice? Would it be beneficial from your perspective to get systematic information about cashflow mismatches and how these would be managed?
No response for the moment.

4. On the EBA's liquidity buffer recommendation:
a) should covered bond issuers hold a "liquidity buffer" to mitigate liquidity risk in the cover pool and, if so, in what circumstances?

b) should the buffer be calibrated to cover the cumulative net out-flows of the covered bond programme over a certain time frame? What length of time should be used as a time frame for calibration purposes?
c) what eligibility criteria should liquid/substitution assets meet to qualify for the purposes of this buffer?
The members of EACB consider the LCR sufficient for the liquidity buffer. Features mitigating liquidity or refinancing risk should already be taken into account in the LCR and NSFR regulation. Hence, no further or specific liquidity buffer requirements should apply to covered bonds issuance.

QUESTIONS – TRANSPARENCY REQUIREMENTS
1. What are your views on the current disclosure requirements set out in Article 129(7) of the CRR? If more detailed requirements were preferred, do you agree that issuers should disclose data on the credit, market and liquidity risk characteristics to a more granular level? If so, what data and to what level of granularity?
The EACB believes that EBA´s considerations on the compliance with CRR´s article 129(7) requirements are going to be taken into account by market initiatives such as the ECBC´s "Common Harmonised Template". We do not think that further requirements are needed because CRR already provides with a framework of minimum transparency that can be further harmonised by market participants' initiatives.

2. Should issuers disclose information on the counterparties involved in a covered bond programme and, if so, what type of information?
No comments.

3. How frequently should covered bond issuers be required to make disclosures to investors?
On a three-monthly basis, which is the industry standard.

4. What are your views on the existing and prospective investor reporting templates prepared by industry bodies and referred to in section 5 of Part III? Would these templates:
a. be granular enough to enable investors to carry out a comprehensive risk analysis as recommended by the EBA? and
b. be sufficient without further legislative backing to deliver enhanced and consistent disclosure in European covered bond markets?

Yes, EACB believes those reporting templates will be transparent enough to allow sufficient disclosure and risk analysis. Investors and Issuers in the European Covered Bond community have in our view a high degree of understanding of the main transparency requirements for the well functioning of the market.

5. Should detailed disclosure requirements apply to all European covered bonds or only to those that would fall within the scope of the Prospectus regime?
No response at this moment.

6. Should the same level of disclosure standards apply pre- and post-insolvency/resolution of the issuer (except for those reporting items referring to the issuer itself)?
No response at this moment.

7. In relation to covered bonds issued in third countries, what minimum level of disclosure should apply for European credit institutions investing in those instruments to benefit from preferential risk weights?

No response at this moment.

Contact:

The EACB trusts that its comments will be taken into account.

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