

22 February 2016

EMF-ECBC POSITION ON THE TREATMENT OF COVERED BONDS IN THE SINGLE RESOLUTION FUND SCHEME AS DESIGNED BY COMMISSION DELEGATED REGULATION (EU) N° 2015/63 OF 21 OCTOBER 2014 WITH REGARD TO EX ANTE CONTRIBUTIONS TO RESOLUTION FINANCING ARRANGEMENTS

Recital 27 of Regulation n° 2015/63 of 21 October 2014 contains the following review clause: *“In order to ensure that the risk adjustment continues to reflect developments in the banking sector and therefore meets the requirements of Directive 2014/59/EU on an ongoing basis, based on the experience gained with its application, the Commission will review the risk adjustment for the calculation of the annual contributions and, in particular, the appropriateness of the risk adjustment multiplier set out in this Regulation and the need for a possible increase of the upper limit the risk adjustment multiplier before 1 June 2016.”*

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)¹ believes that there is a strong case to make use of this review clause to **improve the treatment of covered bonds** in the annual Single Resolution Fund (SRF) contribution scheme.

As a first, general point, the EMF-ECBC would like to underline the fact that covered bonds foster financial stability and support critical functions of the issuing institutions. In fact, during the last financial crisis, the covered bond asset class confirmed its key role as a crisis management tool able to ensure investors' confidence, financial stability and long term financing.

Covered bonds are characterised by significant financial strength, security and a low risk profile and, as a result, the EMF-ECBC believes that a 50% discount rate should be applied to all outstanding covered bonds in the calculation of financial institutions' annual contributions to the resolution financing arrangements.

There are a number of arguments to support this particular treatment:

1. Covered bonds are secured liabilities which provide protection to bondholders in the case of default of the issuing institution by granting a preferential claim on a set of high quality assets in the underlying cover pools. Should an issuing institution default, the cover assets remain segregated from its insolvency estate. In addition, under the Bank Recovery and Resolution Directive (BRRD) rules, covered bonds are generally exempted from the application of the bail-in tool.
2. The mechanisms provided by national covered bond regimes are designed to support the critical functions of the issuing institutions. As indicated above, in case of default of an issuing institution, the asset segregation mechanisms enshrined in the national covered bond laws safeguard the interests of covered bondholders. Specific rules aim at ensuring the transfer of cover assets to other institutions or to a bridge bank. The transfer of cover assets is conceived as an efficient way to sustain financial

¹ Established in 1967, the European Mortgage Federation (EMF) is the voice of the European mortgage industry, representing the interests of mortgage lenders and covered bond issuers at European level. The EMF provides data and information on European mortgage markets, which were worth over €6.9 trillion at the end of 2014. As of February 2016, the EMF has 19 members across 14 EU Member States as well as a number of observer members. In 2004 the EMF founded the European Covered Bond Council (ECBC), which is a platform that brings together covered bond market participants including covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. As of February 2016, the ECBC has over 100 members across 25 active covered bond jurisdictions and many different market segments. ECBC members represent over 95% of covered bonds outstanding, which were worth over €2.5 trillion at the end of 2014. The EMF-ECBC is registered in the EU Transparency Register under ID Number 24967486965-09..

stability and secure critical functions of the underlying institutions. Hence, covered bond specific provisions are driven by the same purposes as most resolution tools of the BRRD.

3. Covered bonds are issued on the basis of strict requirements enshrined in the national law of each Member State. Moreover, they are subject to specific public supervision on an ongoing basis by competent authorities in each jurisdiction. Public supervision ensures the availability of cover assets, thus securing the claims of the bondholders, as well as preventing or at least minimising losses in case of resolution of the institution. The high level of security of covered bonds is widely recognised by the European regulatory framework (among others, UCITS Directive, CRR, Solvency II Regulation, LCR-Regime). The covered bond supervisory regime proved to be the main pillar for the strong investor confidence even during periods of higher market volatility. In turn, covered bonds provided sustainable access to funding for many institutions during the crisis and were in some cases the only source of funding available to them.

The covered bond based business models are structured in such a way as to avoid cover pools' withdrawals from the Single Resolution Fund. It appears therefore justified to calculate the annual contributions of covered bond issuing institutions to the SRF on the basis of 50% of their outstanding covered bonds.

It is important to remember that the application of a 50% discount ratio would be in line with the overall approach of Regulation N° 2015/63 towards covered bonds.

Moreover, article 5 of Delegated Regulation N° 2015/63 provides a list of liabilities which are excluded from the calculation of the annual contributions to the SRF. The EMF-ECBC proposes to complement this provision with a new paragraph (g) as follows:

“(g) 50% of all covered bonds as defined by Article 2 par. 1 N° 96 of Directive 2014/59/EU”

We very much hope that you will take our remarks into consideration. We would of course be more than happy to discuss this topic in more detail and remain at your complete disposal for any additional information or clarification you might require.