

EMF-ECBC Position Paper on interdependent assets and liabilities in the European Commission's Proposal for a regulation (EU) No 575/2013 as regards the Net Stable Funding Ratio

Brussels, 30 March 2017

1. GENERAL OBSERVATIONS

The European Mortgage Federation-European Covered Bond Council (EMF-ECBC)¹ welcomes the objective of the Basel Committee on Banking Supervision and of the European Commission to ensure that financial institutions maintain a stable funding base.

Covered bonds are at the heart of the financial tradition of Europe, playing an important role in funding strategies for the last two centuries and proving to be a cost-effective and reliable long-term funding debt instrument, characterised by **key safety features, including a strict legal and supervisory framework, asset segregation and an actively managed cover pool**.

Covered bonds, with their unique structure, transparency and safety features represent the most stable, and available, funding tool for EU based financial institutions. European banks use them to channel long-term private funding into the real economy in a stable and countercyclical way. Considering the current Capital Markets Union debate, **a sound regulatory environment for such a strategic tool is key to ensuring a proper level playing field at a European and a global level**.

In fact, as already recognised in the **Liquidity Coverage Requirement (LCR) implementation, the covered bond industry plays a fundamental role in providing long-term**, stable financing to the real economy and in investor confidence especially in market turmoil.

Against this background, we would like to make the following recommendation aimed at maintaining the effectiveness of the covered bond as a stable long-term funding tool and achieving legislative consistency across the implementation of the Basel III package.

2. INTERDEPENDENT ASSETS AND LIABILITIES

The European Commission's Proposal for a regulation of the European Parliament and of the Council amending Regulation (EU) No 575/2013 as regards the net stable funding ratio (NSFR), henceforth "the proposal", recognises certain types of covered bonds as interdependent (Article 428 f (2) of the proposal). The EMF-ECBC generally agrees that covered bonds, thanks to their unique safety characteristics, show interdependent features, such as:

- Issuers are required by law to segregate cover assets and covered bonds from other assets and liabilities on their balance sheets, i.e. the assets and liabilities related to the covered bonds are clearly identifiable.
- Covered bonds are secured by a preferential claim on the cover assets. In a bankruptcy scenario, the cash flow received from the cover assets will first be used for the payment of interest and principal on covered bonds and swap counterparties, i.e. the repayment of the principal and the

¹ Established in 1967, the 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 7.0 trillion EUR at the end of 2015. As of October 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 ECBC, a platform bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. As of October 2016, the ECBC has over 100 members across 26 active covered bond jurisdictions and many different market segments. ECBC members represent over 95% of covered bonds outstanding, which were worth nearly 2.5 trillion EUR at the end of 2015. The EMF-ECBC is registered in the EU Transparency Register under the ID Number 24967486965-09.

interest rate payments from the assets cannot be used for anything else until the preferred creditors (covered bond holders and swap counterparties) investors have been repaid

The EMF-ECBC is strongly supportive of the fact that, due to the unique characteristics of the EU covered bond market, and in line with the decision taken by the European Commission in its Delegated Regulation on the LCR, only high quality covered bonds should be regarded as interdependent in the framework of the NSFR.

The EMF-ECBC believes that covered bonds qualifying for the LCR level 2A regulatory treatment mitigate to a very large extent maturity mismatch risk, which is at the root of the interdependence concept. This is because there is a strong link between the regulatory assessed liquidity of a covered bond instrument and the ability of its issuer to refinance maturing issues when needed, thus enabling maturity mismatches to be erased. Covered bonds are subject to strict regulation, public supervision and are a highly transparent asset class – not least thanks to the Covered Bond Label's Harmonised Transparency Template. The Capital Requirements Regulation (CRR) has also introduced increased transparency requirements for the issuer in order for covered bonds to qualify for a preferential capital treatment.

As such, all covered bonds and their cover pools qualifying for the regulatory treatment of the LCR level 2A², and, in particular, compliant with the transparency requirements of article 129(7) CRR, should be considered as interdependent for the purpose of the NSFR. This would also ensure a consistent treatment of covered bonds in the LCR and the NSFR.

3. A POSSIBLE SOLUTION

To make the NSFR rules consistent with those of the LCR, we would suggest adjusting the interdependence point (Article 428 f (2) of the proposal) in the following way:

Current draft:

Article 428f - Interdependent assets and liabilities

[...]

2.

(c) covered bonds as referred to in Article 52(4) of Directive 2009/65/EC;

Proposed draft:

Article 428f - Interdependent assets and liabilities

[...]

2.

(c) covered bonds meeting conditions (i), (ii), (iii), (v) and (vi) of Article 10 1. F) or Article 11 1. C) of the Commission Delegated Regulation (EU) 2015/61.

[...]

² Please refer to Article 11 of Commission Delegated Regulation (EU) 2015/61 of 10 October 2014 to supplement regulation (EU) No 575/2013 of the European Parliament and the Council with regard to liquidity coverage requirement for Credit Institutions (page 11/15 [here](#))