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FUNDING THE REAL ECONOMY

European Covered Bond Council (ECBC)

ECBC Response to the European Commission's Consultation on amending the LCR Delegated Act to cater for covered bonds

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24 November 2020

The European Covered Bond Council, representing 95% of the covered bond industry, would like to thank the European Commission for the ongoing commitment to ensuring that covered bonds remain an essential drive to support the real economy., The Covered Bond Directive (CBD) provides both a useful framework in the EU and a global benchmark reinforcing legal certainty.

We welcome the efforts from the European Commission in the proposed amendment to the LCR Delegated Regulation to address the issue of double-counting which is positive for covered bonds.

We would however like to take this opportunity to highlight the following critical considerations which are extremely relevant for certain jurisdictions:

1) Reference to the CBD as replacement of UCITS definition of covered bonds

The current proposal suggests referring to Article 129 CRR only by deleting Article 52(4) rather than replacing Article 52(4) UCITS with the CBD definition of covered bonds. The significant narrowing to only CRR-compliant covered bonds being eligible as Level 1, 2A and 2B assets should be avoided and all types of CBD compliant covered bonds should be able to qualify as LCR-eligible. The proposed approach is more than an editorial change and risks undermining the intention and initial motivation of creating a European wide, harmonised Covered Bond definition for regulatory purposes.

2) Assets (HQLA) to be deemed unencumbered

The proposal fully recognises as prudentially sound, that liquidity risks related to net outflows in a covered bond programme can be fully covered by assets encumbered in the cover pool. Clarification is needed to ensure that encumbered assets in a cover pool can be deemed to be unencumbered in the LCR requirement up to the amount of net liquidity outflows (the LCR requirement) from the associated covered bond programme – irrespective whether the assets (HQLA) are held as part of the cover pool liquidity buffer or due to other regulatory coverage requirements.

3) Clarification of non-mandatory OC unencumbrance

In some jurisdictions covered bonds are issued through dedicated vehicles, the funding is composed of (privileged) and (non-privileged) resources to fund the non-mandatory OC. While the current proposal solves the issue of liquid assets facing privileged resource outflow, it does not deal with the non-privileged ones, which are however accounted for in the LCR ratio. As all assets of specialised issuers form the cover pool some assets need to become unencumbered to match the arising outflows from non-privileged resources or it becomes structurally impossible to comply with the LCR ratio. Since non-mandatory OC is free to be removed from the covered bond programme all liquid assets counting as non-mandatory OC can be used to match the arising outflows from both privileged and non-privileged resources. It should be clarified that all HQLA in excess and part of the 'non-mandatory OC' in covered bond programmes (according to article 411 (1)(6) in CRR2) should be considered as unencumbered. For this we would kindly ask the confirmation this to be in line with the NSFR rules (according to article 428p (6) (c) in CRR2. Furthermore, it should be explicitly stated that haircuts under the LCR framework are taken into account.

4) Recognition of adjusted net liquidity outflow

The net liquidity outflow from cover pool liabilities and cover pool assets should be adjusted by cover pool HQLA (unencumbered for this purpose only) before the calculation of the LCR is conducted. Thus, only net liquidity outflows which are not covered by (unencumbered) cover pool HQLA add to the LCR and covered bond liabilities that can be fully offset do not change the LCR at all. This is important because the inclusion of (i) the unadjusted net liquidity outflow in the denominator and (ii) unencumbered cover pool HQLA in the numerator will lead to a decrease of the LCR. This is true even if covered bond liabilities are fully covered by HQLA in the cover pool.