

EBA advice on the review of the EU covered bond framework

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The CfA on the EU covered bond framework



EBA asked to provide advice on:

1. Performance of the CB framework
2. Third country equivalence regime
3. European Secured Notes (ESNs)
4. CB with extendable maturities
5. Green CB and ESG risks of cover pools
6. Any other matter related to the framework

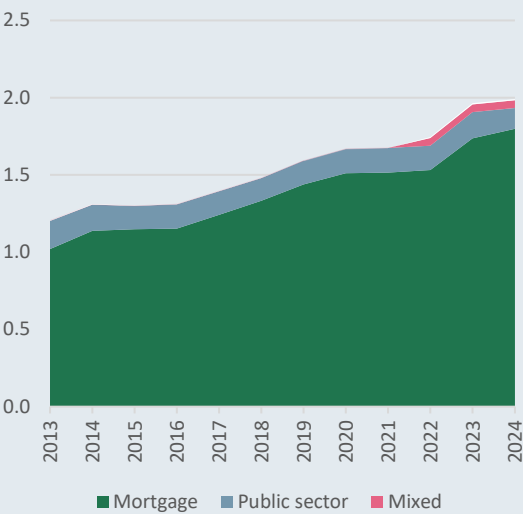


EBA analysis based on:

- EBA survey to national competent authorities on the national implementation of the CBD
- EBA consultation with the industry on the main challenges of the CB market
- Quantitative analysis of the market and the supervisory statistics based on FINREP and ECBC data

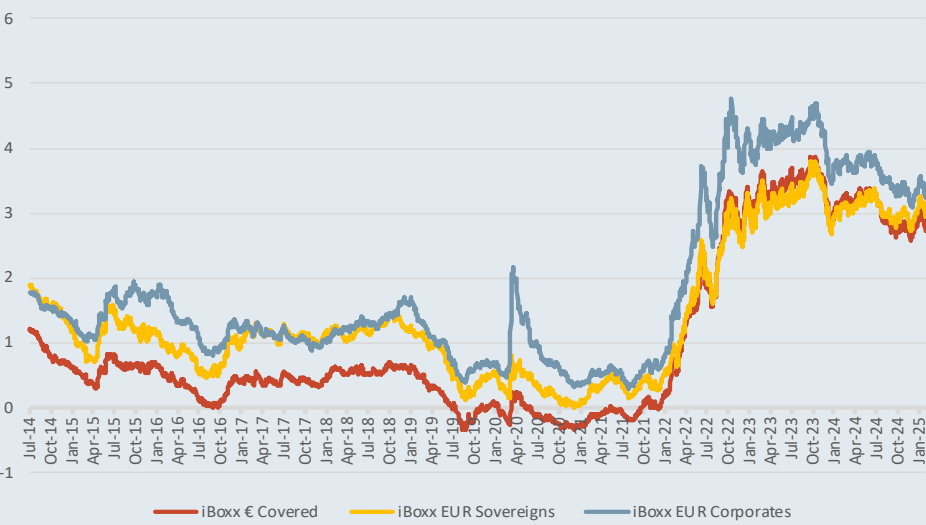
Covered bonds in an important funding channel for EU banks

Market size continues to grow (volumes in tr euro)



Source: ECBC and EBA calculations

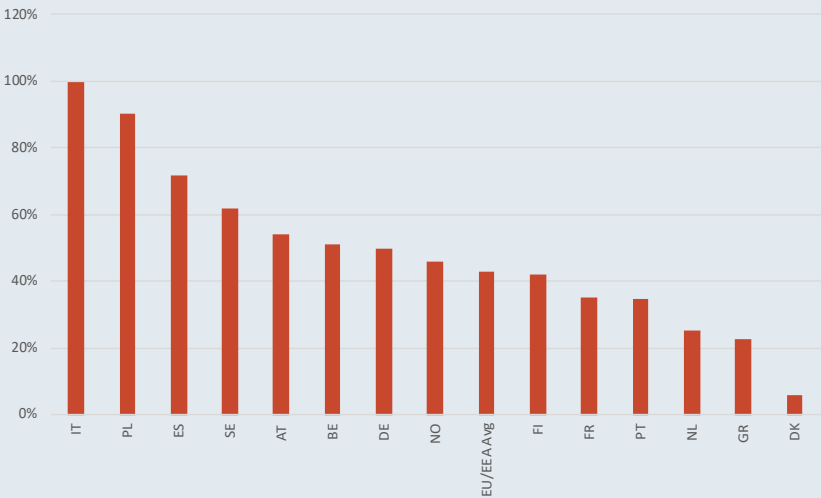
Attractive funding levels for EU banks (credit spread in bps)



Source: Markit and EBA calculations

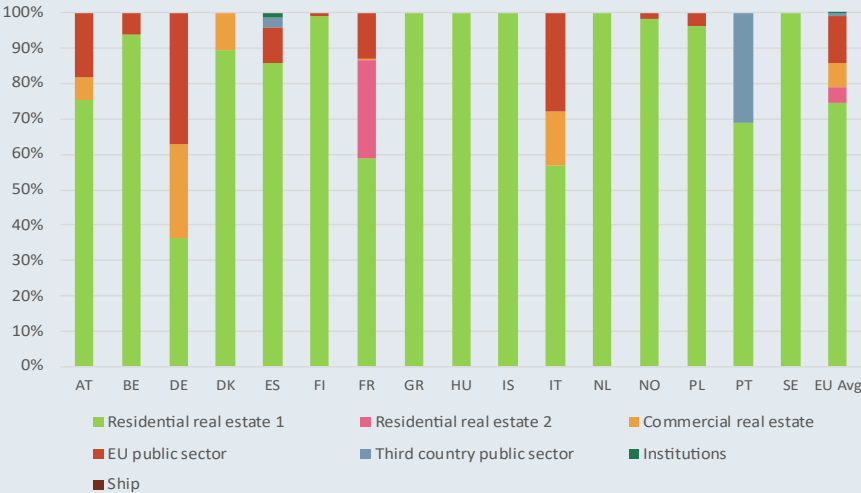
... but still different use of the tool across Member States

Overcollateralisation levels differ significantly



Source: FINREP and EBA calculations.

Cover pools mainly consist of residential mortgages¹



Source: FINREP and EBA calculations, based on consolidated reporting. Dec 2024.

¹ Banks from CY, CZ, EE, HU, IE, LI, LU, RO and SK are not included because there are less than three banks reporting the template F 35.00.c with the highest level of consolidation EEA. The figure includes the distribution of cover pool assets by asset class eligible under CRR and reported in asset encumbrance reporting, which are 89% of the cover pool assets.

EBA main recommendations

1



Harmonise treatment of assets in the CBD with the general credit risk framework (**CRR III**)

2



Establish a **3rd country** regime based on reciprocity

3



Caution on moving forward on **ESNs**

4



Introduce further safeguards on CB with **extendable maturities**

5



Introduce principle-based disclosure on **climate risks** for real estate cover assets

6



Other aspects, including coverage requirements

1 Alignment with the general credit risk framework (CRR III)



Main recommendations:

- **Eligibility for preferential risk treatment** of cover assets in the form of mortgages
 - Align definitions in CRR and covered bonds framework – restricting to the asset types eligible under Art 129
 - Restrictions on eligibility of property under construction
 - Alignment of requirements for Premium CB with **general credit risk treatment** (e.g., limitations on the use of real estate under construction)
- Considerations on the **valuation method** applied to immovable property
 - Alignment would be simpler, but different national practices exist today
- Treatment of covered bonds in presence of **defaulted issuer**
 - Recognition that **unsecured-like treatment** can raise uncertainty in the unlikely case of default

2 Establishment of a third country equivalence regime



Main recommendations:

- **Positive** opinion from the **cost-benefit analysis** about the introduction of the regime
- **Reciprocity** with the 3rd country authority as overarching rule
- **CBD** principles as the main **scope** of the equivalence assessment²
- **Prerequisites** to initiate the assessment: comparability of the 3rd country:
 - **Definition** of credit institution
 - **Quality** of supervisory framework
- **Sets out technical steps** of the process (application process, which will include assessment of **maturity** of the 3rd country market, supervision requirements and commitment to reciprocity)

3 Caution on moving forward on ESNs at this stage



Main recommendations:

- **European Structured Notes** can add value to the universe of secured products
 - Focus would be on unlocking further elements of bank balance sheets for funding purposes, i.e. using SME lending as collateral
 - Would introduce a simpler instrument, built on covered bond principles, but simpler than securitisation
- EBA is nonetheless taking a cautious approach:
 - No initiative from the industry coming in this area
 - Concerns remain on the heterogeneity of SME lending, higher default rates among SME loans, difficulty in harmonising risk metrics would be challenges to overcome
- EBA recommends further technical analysis and re-opening a debate at a later stage

4 Introduction of safeguards for CB with extendable maturities



Main recommendations:

- Enhanced **involvement** of the **national competent authority** in the maturity extension process:
 - Ensuring the **objectivity of the triggers** for extending maturity – finite list of triggers
 - Inquiring the role of the issuer in the run-up to the **realisation of the trigger** (i.e., its unavailability)
 - Active involvement of investors to ensure
- Stricter requirements for the use of the **final maturity** in the calculation of the **liquidity buffer** and require credible plans for its reconstitution in case of depletion

5 Introduce principle-based disclosure on climate risks



Main recommendations:

- ESG risks is still developing – **limit disclosure to climate risks** (which include both **transition** and **physical risk**)
- **Annual disclosure** of climate risks for real estate cover assets is recommended
- The voluntary disclosure in place to at EU level is sufficient...
- ... but need for ensuring reference to the voluntary disclosure in the national frameworks

6 Other aspects



Main recommendations:

- Clarifications on coverage requirements (art 15 CBD)
 - Increase clarity on statutory coverage, consider wind-down costs, lowering of statutory over-collateralisation assessed by supervisors
- Removal of option to have internal **cover pool monitor** and additional safeguards introduced
- Strengthening the protection of **derivative instruments** in the cover pool
 - Posting of segregated high-quality collateral
 - For internal derivative transactions, an alternative counterparty shall be appointed, ready to step in upon the default of the counterparty/issuer
- No recommendations on supervision or asset encumbrance

Conclusions



Main takeaways from the EBA Report:

- The EU CB market is an **important funding tool** for EU institutions, and it has proven to be well-functioning and resilient
- Extension to 3rd country recognition through equivalence regime would add value, but important to ensure that also 3rd countries have a sound framework, built on the principles of the CBD
- The EU CB legal framework is still **not fully harmonised** across Member States, thus creating opportunities for further alignment, in terms of understanding and comparability of the national systems, thereby allowing for a more integrated covered bonds market



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