24th Central European Covered Bond Conference

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Panel 1: EU Covered Bond Directive and Regulation – Transitional measures unknotted

Summary by Maureen Schuller

Moderator:

- Maureen Schuller, Head of Financial Research, ING Bank N.V., Amsterdam

Panelists:

- Roberta De Filippis, EBA, Paris
- Sascha Kullig, Member of the Management Board, vdp, Berlin
- Izabela Makowska, Head of Legal Department, mBank Hipoteczny, Warsaw
- Markus Nilssen, Partner, Bahr AS Advokat Partner, Oslo

SUMMARY

Two transitional measures, one at the level of the European Covered Bond Directive (CBD) and one at the level of the amended CRR, with one simple purpose: Making sure that existing covered bonds can keep their current status, also after the provisions from the CBD and amended CRR entered into force on 8 July 2022.

At the 24th Central European Covered Bond Conference in Warsaw on 9 June 2022, the 1st panel discussion ("European Covered Bond Directive and Regulation – Transitional measures unknotted") showed that transposing the transitional measures into national law was not as simple as it seemed. Sascha Kullig (vdp), Izabela Makowska (mBank) and Markus Nillsen (BAHR) explained the interpretation issues with the transitional provisions from Article 30 CBD and Article 129(7) CRR in Germany, Poland and Norway, while Roberta De Filippis (EBA) shed further light on these measures by sharing her personal understanding of the provisions.

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Article 30(1) CBD states that *"Member states **shall ensure** that covered bonds issued before 8 July 2022 that comply with the UCITS 52(4) requirements as applicable on the date of their issue, **are not subject to** the minimum requirements set out in CBD Article 5-12, 15-17 and 19, but continue to be referred to as covered bonds in accordance with the CBD until their maturity"*.

Already well ahead of the Central European Covered Bond Conference in Warsaw, the interpretation difficulties in some countries related to this article was brought to the attention of the vdp Roundtable Covered Bond Legislation (RT CBL). Particularly the words "shall ensure" and "are not subject to" caused confusion. Do the words "shall ensure" mean that member states "must ensure" that existing covered bonds are not subject to the stated provisions of the CBD? And do the words "are not subject to" mean that existing covered bonds "are not allowed to be subject to" these provisions from the CBD?

Recital 41 of the CBD clarifies that covered bonds issued before 8 July 2022 should not be affected by certain provisions of the CBD, while Recital 5 underscores the principal based nature of the CBD, meaning that member states do have discretion on how to regulate certain aspects in national law. As such, like the vdp RT CBL, Panel 1 did come to the conclusion that Article 30(1) does not mean that national regulators are not allowed to apply all CBD articles to existing covered bonds ('shall ensure ≠ must ensure' and 'are not subject to ≠ are not allowed to be subject to').

Where it only makes sense to apply these provisions to both outstanding and new covered bonds, they may be applied to both groups of covered bonds, such as in the case where existing and new covered bonds are secured by one and the same cover pool.

For similar reasons, ie to ensure that existing covered bonds can keep their preferential status, **Article 129(7) of the amended CRR** provides that *"Covered bonds issued before 8 July 2022 that comply with the requirements of the CRR applicable at the date of their issue, shall not be subject to the new requirements laid down in CRR Article 129(3a) and (3b), but shall be eligible for preferential treatment under CRR Article 129(4) and (5) until maturity"*. Irrespective of this grandfathering provision, covered bonds issued before 8 July 2022 would still have to meet some of the amended CRR requirements to maintain their preferential status after 8 July 2022. These include for instance the annual property monitoring requirements, including for residential properties, per Article 129(3) of the CRR. The grandfathering provisions would only apply to Article 129(3a) and Article 129(3b), which set the new minimum 5% overcollateralization requirement and eligibility criteria for substitution assets. However, the problem with these requirements is that they both apply to the cover assets, while the grandfathering provisions of Article 129(7) are related to the covered bonds.

Panel 1 agreed to the conclusion of the vdp RT CBL that, if the covered bond legislation does not provide for the establishment of new cover pools after 8 July 2022, but instead assumes a continuation of existing cover pools for new covered bonds, active covered bond programmes cannot benefit from the grandfathering provisions of Article 129(7) of the CRR. They therefore also need to fulfil the overcollateralization requirements from Article 129(3a) and the eligibility criteria for substitution assets from Article 129(3b).

The views on whether this would also apply to the liquidity buffer requirements from the CBD (also asset side) did differ however. Norway, for instance, plans to subject only covered bonds issued after 8 July 2022 to the new 180 days liquidity buffer requirements, whereas covered bonds issued before that date would be subject to the old liquidity provisions. Both the new and old covered bonds would nonetheless be secured by the same cover pool.

Instead, when it comes to the provisions from the CBD on extendable maturity structures (covered bonds side) it was perceived easier to make a distinction between old and new covered bonds. Article 17(1)(b) CBD requires that the maturity extension triggers are specified in the covered bonds' terms and conditions. Considering the undoable task of changing all the final terms for the numerous covered bonds outstanding, Germany decided to impose this requirement only to new covered bonds to be issued after 8 July 2022, although statutory law introduced extension provisions since 1 July 2021 for all covered bonds, old and new ones. The amendments in Poland, where extendable maturity provisions in the event of bankruptcy already existed for several years, the terms and conditions already contain the information on extension triggers. However, Polish parliament went beyond the CBD requirements and extended the duty to amend the terms and conditions referred to in Article 17(1)(b) to letter (c)(ii) as well, where the CBD stipulates that the information provided to investors has to explain the consequences for a maturity extension not only of an insolvency procedure, but also of a resolution procedure. This latter resolution item was not explained in the old terms and conditions for Polish covered bonds. Therefore, both the German and Polish law do not allow the new European label for their covered bonds, issued before 8 July 2022.

Thanks to the transitional measures applicable to the covered bonds issued before 8 July 2022, both for Germany and Poland the old covered bonds do nonetheless keep their status as covered bonds for the purpose of the CBD and for preferential risk weight treatment under the amended CRR. However, Panel 1 did agree that these covered bonds would not be able to use the label European Covered Bond, or European Covered Bond (Premium) – and that therefore the labelling provisions in both countries are in line with the CBD. After all, not all the new provisions under the CBD (and as such the CRR) would apply to these old covered bonds. Instead, new (CRR eligible) covered bonds issued after 8 July 2022 would not only be eligible for preferential treatment, but would also be able the use the label European Covered Bond (Premium).

While Panel 1 was uniform in its conclusions on the interpretation of the transitional measures, it felt that more discussion is needed on another topic briefly touched upon during the panel session. Namely, regarding the necessity of still meeting the regulatory overcollateralization requirements and liquidity buffer requirements in a post-issuer insolvency situation. Particularly the consequences for the preferential treatment of covered bonds of not meeting these requirements post-issuer insolvency, remains a question open to further debate. A great topic the next Central European Covered Bond Conference might be able to provide an answer to…. who knows.