EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 23 December 2013

on covered bonds

(CON/2013/94)

Introduction and legal basis

On 2 December 2013, the European Central Bank (ECB) received a request from Banca Națională a României (BNR) for an opinion on a draft law on covered bonds (hereinafter the 'draft law').

The ECB's competence to deliver an opinion is based on Articles 127(4) and 282(5) of the Treaty on the Functioning of the European Union and the third and sixth indents of Article 2(1) of Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions[1], as the draft law relates to BNR and to rules applicable to the financial institutions insofar as they materially influence the stability of financial institutions and markets. In accordance with the first sentence of Article 17.5 of the Rules of Procedure of the European Central Bank, the Governing Council has adopted this opinion.

1. Purpose of the draft law

1.1 The purpose of the draft law is to set up a legal framework for the issuance of covered bonds by credit institutions that is in line with best European practices and to foster the development of the domestic capital market

1.2 The draft law defines: (a) the institutions allowed to issue covered bonds, i.e. banks and mortgage banks that are Romanian legal entities, and BNR's authorisation procedures concerning issuers and issues of covered bonds; (b) the types of assets eligible for inclusion in the cover pool of covered bonds, i.e. mortgage loans, substitution assets and hedging derivatives, and the valuation and composition of the cover pool; (c) the structure of the cover pool, where issuers must ensure the quality of the cover pool during the entire lifetime of the bonds by replacing, if necessary, assets that no longer meet the eligibility criteria; (d) the rules regarding issuance and supervision of covered bonds and management of the cover pool; (e) the covered bond holders' rights; (f) special provisions in case of an issuer's bankruptcy; (g) transparency requirements.

1 OJ L 189, 3.7.1998, p. 42.

1.3 The draft law establishes a set of rules to protect covered bond holders' rights. In particular, they have the right to satisfy their claims against the issuer by having priority as regards recourse to the cover pool and no other creditor of the issuer, regardless of the nature of its claim, may initiate a foreclosure on the entire cover pool or on a part of it prior to the covered bond holders. Such protection becomes particularly relevant in the event of a bankruptcy procedure with respect to covered bond issuers. Until and unless all the issuer's obligations towards the covered bond holders have been fulfilled, the cover pool securing the covered bonds will not form part of the issuer's estate undergoing a liquidation procedure and will not be affected by such a procedure. Moreover, the servicing of the cover pool continues during and after completion of bankruptcy proceedings until all claims in the cover pool have been realised. The draft law also provides the possibility to accelerate the fulfilment of the issuer's obligations towards the covered bond holders by assigning the claims in the cover pool to a third party, with the bond holders' prior consent. In such a case, to the extent the proceeds of the assignment are insufficient to satisfy in full the claims of the covered bond holders, they also have recourse to the issuer's estate for the remainder of the claim, ranking *pari passu* with unsecured creditors.

1.4 Following the entry into force of the draft law, BNR is to adopt additional regulations for its implementation, *inter alia*, on: (a) the conditions regarding authorisation for the issuance of covered bonds; (b) the categories, eligibility criteria and maximum limits applicable to substitution assets; (c) the ratio between the total value of covered assets and the total value of the issuer's assets; (d) the methodology used when assessing and managing the liquidity risk of covered bonds; (e) the methodology used when determining the weighted averages of maturities of covered bonds and claims securing the covered assets; (f) the rules regarding the internal cover register; and (g) the rules regarding quarterly reports to fulfil the transparency requirements.

1.5 When the covered bond issue is carried out by subscription in a public offer, this has to take place on the basis of a prospectus approved by the Financial Supervisory Authority, as the competent authority of the home Member State, in accordance with Law No 297/2004 on the capital market[2] and Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council[3].

2. General observations

2.1 The draft law aims to enhance legal certainty with regard to the legislative framework on covered bonds in Romania. A number of provisions in the draft law are targeted at ensuring the protection of bond holders, which may allow banks to issue covered bonds that comply with Directive

2 Published in *Monitorul Oficial al României*, Part I No 571/2004.

3 Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (OJ L 149, 30.4.2004, p. 1).

2009/65/EC of the European Parliament and of the Council[4] and with Directive 2006/48/EC of the European Parliament and of the Council[5]. Covered bonds play an important role in Union financial markets; therefore it is important to have sound legal rules in place, particularly with regard to financial stability.

2.2 In order to preserve the financial situation of banks and the quality of their assets, the ECB welcomes the provision stating that BNR may require an issuer to provide own funds at a level higher than that provided for under Regulation (EU) No 575/2013 of the European Parliament and of the Council if the ratio between the total cover assets and the total assets of the issuer exceeds the one established by BNR.

2.3 Article 9(1) of the draft law states that the net present value of the cover pool has to exceed the net present value of the liabilities assumed through one covered bond issue with a certain collateralisation percentage. Article 8 regulates a structure based on a single cover pool, which may secure various issues of covered bonds. Therefore, the above-mentioned provision may better refer to the aggregate value of all the issues plus the amount corresponding to the collateralisation percentage applicable to each of them, rather than to a single issue.

2.3 Article 9(2) of the draft law sets out a tool for monitoring and managing liquidity risk of the cover pool, by requiring the issuer to cover the largest difference between the cash flows generated by claims in the cover pool and the maturing covered bonds with liquid substitution assets, as determined on a daily basis for a 180-day period. The draft law should clarify from what date and how this 180-day period is to be calculated and whether it is intended to actually refer to consecutive periods of 180 days.

This opinion will be published on the ECB's website.

Done at Frankfurt am Main, 23 December 2013.

[signed]

The President of the ECB

Mario DRAGHI

4 Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

5 Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (OJ L 177, 30.6.2006, p. 1). After 1 January 2014, this directive will be replaced by a new framework, established by Directive (EU) 2013/36 of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC (OJ L 176, 27.6.2013, p. 338) and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 (OJ L 176, 27.6.2013, p. 1).