FINANCE FINLAND

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European Commission

Consultation on Initiative on an integrated covered bond framework (COM(2018)93) and (COM(2018)94)

FFI Comments on Commission's Covered Bond proposal

We welcome the opportunity to give feedback on the Commission's initiative on an integrated covered bond framework. We appreciate that the Commission has noted the well-functioning markets in many member states and keeps the harmonisation as principle based.

Covered bond funding is especially important for Nordic countries. In Finland, roughly one third of mortgage loans are funded by covered bonds. It has proved to be a stable funding source with historically low loss ratios, even during financial stress.

We support the Commissions aim to enhance the use of covered bonds as a stable and cost-effective source of funding for credit institutions. We would like to particularly highlight the importance of cost-effectiveness. In Finland, also small banks issue covered bonds. Thus, it is especially important not to increase the fixed costs for issuers to keep the small players in the market as well.

Even though we find the proposal balanced overall, we think there are certain risks which might hamper the well-functioning and cost-efficient market we have today.

1 Requirement for a cover pool liquidity buffer

The proposed article 16 of the Directive sets requirements for a cover pool liquidity buffer. The cover pool liquidity buffer shall cover the net liquidity outflow for 180 calendar days. The liquidity buffer requirement at the cover pool level would increase the funding costs.

We found the buffer requirements excessive, considering elements already in place in other regulation. Firstly, issuers are already subject to strict LCR liquidity buffer requirements, which are calibrated for stressed conditions. Secondly, in the substantial revisions to CRR (CRR2) proposal for net stable funding ratio (NSFR), covered bonds with remaining maturity of less than 6 months will not constitute any available stable funding. Banks need to cover the shortfall with other forms of stable funding. Above all, we think that the calibration of the final NSFR should not penalise secured funding and should not create such cliff effects.

Furthermore, it should be analysed at the EU level if there is really a need for a cover pool liquidity buffer requirement (art. 16) considering the proposed treatment of covered bonds under NSFR in CRR2.

There is also some uncertainty if the liquidity buffers need to be on the balance sheet of the covered bond issuer or if the covered bond issuer can benefit from the liquidity buffers within the group.

2 Conditions for extendable maturity structures

The proposed article 17 of the Directive includes conditions for extendable maturity structures. Roughly half of the covered bonds issued in Finland include such features. Therefore, article 17 and its final content is very important to Finnish issuers.

Maturity extension is an important tool for issuers to manage liquidity and re-funding risks and the use of these structures should not be penalised. Therefore, it should be taken into consideration if a soft bullet structure could replace the possible liquidity buffer requirement in article 16.

Furthermore, it is unclear how the requirement in article 17.1(b) should be interpreted, saying "…the maturity extension is not to be triggered at the discretion of the issuer…". We would like to get clarification on the definition of "triggers" and also what exactly means "at the discretion".

3 Dual recourse

Article 4 of the Directive lays down the rules for dual recourse. In our national legislation, we have a possibility to expand the dual recourse to derivative counterparties of the cover pool. This possibility makes it easier to find counterparties and may also affect the pricing. We would like to maintain an option for this.

4 Composition of the cover pool

Article 10 of the Directive states that "assets in the cover pool - - shall be of a similar nature in terms of structural features, lifetime of assets or risk profile".

Finnish covered bond legislation allows residential and commercial assets to be included in the same cover pool. In our view, difference in risk profile between residential and commercial real estate is already catered for by having different loan-to-value (LTV) levels for cover pool eligibility and caps for the percentage of commercial assets that can be included in the covered pool. Hence, there is no need for EU-legislation regarding the composition of the cover pool. Diversification can be positive for certain investors, and investors generally have the knowledge to understand a diversified pool.

5 Derivative contracts in the cover pool

In article 11 (2)(b), the directive introduces a limit on the amount of derivative contracts in the cover pool. Our view is that a limit on derivatives will contradict the benefit of using derivatives for hedging purposes.

6 Investor information

Article 14 of the Directive states which information should be provided to investors. For listed covered bonds, there is already legislation implemented through the Finnish Securities Market Act. We would like to make sure that there is not going to be duplicative or overlapping rules for covered bond issuers on how to inform investors.

Particularly, point 2(c) should be clarified, whether this means numerical values or qualitative assessment.

7 CRR art 129

The proposed amendments to article 129 of the CRR introduce a new requirement on a minimum level of over-collateralisation. This level is set at 2 and 5%, depending on the assets in the cover pool, based on a nominal calculation method. Even though market aspects, including investors' expectations regarding credit ratings of the covered bonds, may promote higher levels of collateralisation, this may vary case by case depending on the issuers, assets of the cover pool and other factors. The two percent requirement has worked very well in Finland. Hence, the legislation should aim at providing flexibility to issuers together with sufficient investor protection, and leave room for markets to decide whether more collateral is needed in each case, or not.

In the amendment of article 129.1.iii.b, it is proposed that "for exposures to credit institutions that qualify for the credit quality step 1 the exposure shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution." One aspect that needs to be considered at EU level is the potential implications for smaller institutions. The proposed limit may make it more difficult for smaller institutions to get enough different investors in order not to exceed the limit.

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