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COVER NOTE

From: Secretary-General of the European Commission,
signed by Mr Jordi AYET PUIGARNAU, Director

date of receipt: 12 March 2014

To: Mr Uwe CORSEPIUS, Secretary-General of the Council of the European
Union

No. Cion doc.: C(2014) 1553 final

Subject: COMMISSION DELEGATED REGULATION (EU) No .../.. of 12.3.2014
supplementing Regulation (EU) No 575/2013 of the European Parliament
and of the Council with regard to regulatory technical standards for
determining what constitutes the close correspondence between the value of
an institution's covered bonds and the value of the institution's assets

Delegations will find attached document C(2014) 1553 final.

Encl.: C(2014) 1553 final



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COMMISSION DELEGATED REGULATION (EU) No .../..

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(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Article 33(4) of Regulation (EU) No 575/2013 ('the Regulation') empowers the Commission to adopt, following submission of draft standards by the European Banking Authority (EBA), and in accordance with Article 10 of Regulation No (EU) 1093/2010, delegated acts specifying what constitutes the close correspondence between the value of the bonds and the value of the assets, as mentioned in Article 33(3)(c) of the Regulation.

Article 33(1)(b) of the Regulation establishes, that institutions cannot include gains and losses on fair-valued liabilities stemming from changes in the standing of own credit risk. However, in Article 33(3) an exemption from this principle is made as regards covered bonds, subject to a number of conditions. In particular, a close correspondence between the assets and liabilities of the institution must exist. This is allowed as changes can be included in own funds due to the fact that offsetting value adjustments are to be applied on the assets side of institutions' balance sheets, as a result of the very same changes in the institutions' own credit risk profiles. It is further specified that such exceptions only apply where institutions issue mortgage loans financed by covered bonds that also can be pre-paid by the borrower by purchasing the corresponding bonds on the secondary markets and delivering them to the bank. When all the conditions of close correspondence between the market value of the bonds and the market value of the loans apply, offsetting fair value changes taken to own funds result in an overall unchanged level of regulatory capital for the reporting institution.

In accordance with Articles 10 to 15 of Regulation No (EU) 1093/2010 establishing the EBA, the Commission shall decide within three months of receipt of the draft standards whether to endorse the drafts submitted. The Commission may also endorse the draft standards in part only, or with amendments, where the Union's interests so require, having regard to the specific procedure laid down in those Articles.

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

In accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, the EBA has carried out a public consultation on the draft regulatory technical standards (RTS) submitted to the Commission in accordance with Article 33(4) of Regulation No (EU) 575/2013. A consultation paper was published on 19 July 2013, and the consultation closed on 1 September 2013. Moreover, the EBA invited the EBA's Banking Stakeholder Group set up in accordance with Article 37 of Regulation No (EU) 1093/2010 to provide advice on the consultation paper.

As specifically requested by the Commission, only the draft technical standard and explanatory memorandum are submitted to the Commission for the adoption of the RTS. All relevant background information –notably the background and rationale of the draft technical standards, the impact assessment and the feedback on the public consultation- is included in the full version of the EBA RTS, which was approved by the EBA's Board of Supervisors on 27 September 2013 and published on the EBA's public website.

3. ANALYSIS OF COSTS AND BENEFITS

Together with the draft technical standards, and in accordance with the third subparagraph of Article 10(1) of Regulation No (EU) 1093/2010, EBA has submitted an analysis of the costs and benefits related to the draft technical standards submitted to the Commission. This analysis is available at:

<http://www.eba.europa.eu/documents/10180/423258/EBA+RTS+2013+05+%28Final+draft+RTS+on+covered+bonds+close+correspondence%29.pdf/e3910a23-863a-486c-8038-46a7d9f566b4> pages 9-11.

4. LEGAL ELEMENTS OF THE DELEGATED ACT

All the provisions in this delegated act relate to the specification of the conditions to assess whether a close correspondence between the value of a covered bond (as referred to in Article 52(4) of Directive 2009/65/EC) and the value of the institutions' assets exist.

In any case, a close correspondence does not deem to exist whenever a net profit or loss arises from changes in the value, either of the covered bonds or the underlying mortgage loans with the embedded delivery option.

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of 12.3.2014

supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards for determining what constitutes the close correspondence between the value of an institution's covered bonds and the value of the institution's assets

(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to 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 648/2012¹, and in particular Article 33(4) thereof,

Whereas:

- (1) Gains or losses on liabilities of an institution resulting from changes in its own credit risk should not, in principle, be included as an element of own funds. However, in business models based on the strict match funding or balance principle that rule is not applied, on the premise that a decline or an increase in value of a liability is fully offset by a corresponding decline or increase in value of the asset, with which that liability is fully matched.
- (2) It is important to set the requirements for determining whether a close correspondence exists between the liabilities of an institution consisting in a covered bond as referred to in Article 52(4) of Directive 2009/65/EC of the European Parliament and of the Council² and the value of the institution's assets underlying the covered bonds.
- (3) Close correspondence should be reflected in the accounting treatment of those bonds and the underlying mortgage loans, without which it would not be prudent to recognise gains and losses stemming from changes in own credit risk.
- (4) A delivery option allows the borrower to buy back the specific covered bond financing the mortgage loan in the market and deliver the covered bond to the bank as an early prepayment of the mortgage loan. As a consequence of the availability of that option to the borrower, the fair value of the mortgage loans should at all times be

¹ OJ L 176, 27.6.2013, p. 1.

² 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).

equal to the fair value of the covered bonds financing those mortgages. This implies that the calculation of the fair value of the mortgage loans should include the fair valuation of the embedded delivery option according to established market practices.

- (5) This Regulation is based on the draft regulatory technical standards submitted by the European Banking Authority to the Commission.
- (6) The European Banking Authority has conducted open public consultations on the draft regulatory technical standards on which this Regulation is based, analysed the potential related costs and benefits and requested the opinion of the Banking Stakeholder Group established in accordance with Article 37 of Regulation (EU) No 1093/2010 of the European Parliament and of the Council³,

HAS ADOPTED THIS REGULATION:

Article 1

Definitions

The following definitions shall apply:

1. (1) “*covered bond*” means a bond as referred to in Article 52(4) of Directive 2009/65/EC;
2. (2) “*delivery option*” means the possibility to redeem the mortgage loan by buying back the covered bond at market or at nominal value in accordance with Article 33 (3)(d) of Regulation (EU) No 575/2013.

Article 2

Close correspondence

1. A close correspondence between the value of a covered bond and the value of an institution’s assets shall be deemed to exist when all the following conditions are met:
 - (a) any changes in the fair value of the covered bonds issued by the institution results at all times in equal changes in the fair value of the assets underlying the covered bonds. The fair value shall be determined according to the applicable accounting framework as defined in Article 4(1)(77) of Regulation (EU)No 575/2013;
 - (b) the mortgage loans underlying the covered bonds issued by the institution to finance the loans may be at any time redeemed by buying back the covered bonds at market or nominal value through the exercise of the delivery option;

³ Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/78/EC (OJ L 331, 15.12.2010, p. 12).

- (c) there is a transparent mechanism for determining the fair value of the mortgage loans and of the covered bonds. Determining the value of the mortgage loans shall include calculating the fair value of the delivery option.
2. A close correspondence shall not be deemed to exist where, in accordance with paragraph 1, a net profit or loss arises from changes in the value of the covered bonds or of the underlying mortgage loans with the embedded delivery option.

Article 3

Entry into force

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 12.3.2014

For the Commission
The President
José Manuel BARROSO