

FAQs on the Eurosystem's third covered bond purchase programme (CBPP3)

This document sets out some frequently asked questions on the Eurosystem's third covered bond purchase programme (CBPP3), announced on 4 September 2014. It complements the information contained in the ECB decision of 15 October 2014 (ECB/2014/40) and the Technical Annex of 2 October 2014.¹

1. Questions on bond eligibility

Q1.1: What are the maximum and minimum maturities of covered bonds eligible for purchase under the CBPP3?

A: No maximum or minimum maturity has been defined for the programme.

Q1.2: What is the minimum issuance volume of covered bonds eligible for purchase under the CBPP3?

A: No minimum issuance volume has been defined for the programme.

Q1.3: How will you treat a covered bond purchased under the CBPP3 if it has two or more ratings? Which rating do you use?

A: If multiple, and possibly conflicting, ECAI assessments are available (i.e. external credit ratings provided by any of the four external credit assessment institutions, or eligible credit rating institutions, namely Standard & Poor's, Fitch, Moody's and DBRS), the first-best rule will be applied. For covered bonds that do not have the credit quality step 3 rating in Cyprus and Greece, a minimum asset rating at the level of the maximum achievable covered bond rating defined for the jurisdiction will be required.

Q1.4: The eligibility criteria for the CBPP3 foresee that only securities accepted for own use (as laid out in Section 6.2.3.2 of Annex I to Guideline ECB/2011/14, "The implementation of monetary policy in the euro area – General Documentation on Eurosystem monetary policy instruments and procedures") can be purchased. Can you confirm this and also describe the treatment given to *multi-cédulas*?

¹ See links: https://www.ecb.europa.eu/ecb/legal/pdf/oj-jol_2014_335_r_0010-en-txt.pdf and https://www.ecb.europa.eu/ecb/legal/pdf/oj-jol_2014_335_r_0010-en-txt.pdf

A: In principle, all covered bonds that comply with the eligibility criteria established in Annex I to the Guideline (ECB/2011/14) as amended and that, in addition, fulfil the conditions laid out in the fifth paragraph of Section 6.2.3.2 are eligible. Concretely, this paragraph states that the Eurosystem exempts specific debt instruments from the “close links” rule. As such, covered bonds can be “own-used” as collateral by the issuer (or by a closely linked counterparty) if they are CRD/CRR-compliant or they are protected by specific legal safeguards that make them comparable to CRD/CRR-compliant covered bonds. *Multi-cédulas* are considered eligible for CBPP3 purchases as clarified in the ECB Decision of 15 October 2014 (ECB/2014/40).

Q1.5: Are registered covered bonds (e.g. German *Namenspfandbriefe*) part of the investable universe?

A: *Namenspfandbriefe* are not eligible under the Eurosystem collateral framework, as these instruments do not meet the criterion that a debt instrument must be transferable in book-entry form (Section 6.2.1.4, “Settlement procedures”, of Guideline ECB/2011/14). Instead, the transfer of a *Namenspfandbrief* usually takes the form of an assignment, as the owner is registered in a separate register.

Q1.6: Does the prohibition of monetary financing, as laid down in Article 123 of the Treaty on the Functioning of the European Union, have to be respected under the CBPP3 in terms of purchases of bonds issued by publicly owned credit institutions?

A: Purchases made under the CBPP3, which are monetary policy operations and constitute supply of reserves, make no distinction between covered bonds issued by public sector credit institutions and those issued by private sector institutions. This is in line with the provisions of paragraph 2 of Article 123 of the Treaty.

Q1.7: Does the issue share limit of 70% apply only to CBPP3 holdings?

A: No, the 70% limit applies to the combined holdings of all three of the Eurosystem’s covered bond purchase programmes and the Eurosystem’s investment portfolios.

2. Questions on retained bonds

Q2.1: What is the interest for banks to sell retained covered bonds to the CBPP3 whereas they are already placed at the ECB for repo purposes?

A: It is up to individual institutions to manage their own funding sources, including liability structure, maturity breakdown and any decision between the market-placement and retention of bonds.

Q2.2: Does the issue share limit of 70% per international securities identification number (ISIN) also apply to “fully retained” issues?

A: Yes.

3. Questions on procedures

Q3.1: Will income and losses be shared within the Eurosystem?

A: As a rule, income and losses from decentralised monetary policy operations conducted by the Eurosystem are shared.

Q3.2: Will there be specialisation across jurisdictions and maturities?

A: For efficiency reasons, the Eurosystem’s internal decisions on the allocation of particular purchases to its members take due account of their specific competencies.

4. Questions on collateral eligibility

Q4.1: Under the CBPP3, the Eurosystem will be able to buy up to 70% of a securities issue per international securities identification number (or 30% in the case of Greece and Cyprus). In the case of the remaining 30% (or 70%), are these eligible for Eurosystem repo purposes, assuming they meet the covered bond requirement criteria?

A: If all eligibility criteria are fulfilled, the remaining outstanding amount of the covered bonds can be used as collateral in Eurosystem credit operations.

5. Questions on CBPP3 securities lending

Q5.1: What do you mean by “matched repo transactions”?

A: Lending of covered bonds held in the CBPP portfolios can be conducted through matched repo and reverse repo transactions. This means that a covered bond can be lent in repos to eligible counterparties against cash, which can then be reinvested against another eligible bond. Lending is voluntary and may be decided by each Eurosystem member separately.

Q5.2: What will be the rate or spread for CBPP3 securities lending?

A: Each Eurosystem member lending CBPP3 bonds sets the rate and agrees the eligible collateral with counterparties.

Q5.3: Are bonds purchased under the Eurosystem's first two covered bond purchase programmes (CBPP1 and CBPP2) available for lending? If so, will they be available to all counterparties eligible for CBPP3 or only the narrower set of counterparties eligible for CBPP1 and CBPP2?

A: The holdings under CBPP1 and CBPP2 are available for lending to the broader set of counterparties eligible for CBPP3. Lending is voluntary and may be decided by each Eurosystem member separately.

6. Other questions

Q6.1: My internal compliance unit asks if the Eurosystem would give permission to say, for example, "We have seen decent buying by the Eurosystem of 5-7 year Dutch covered bonds in bigger clips, which tightened spreads by 2 basis points." (We would never state which Eurosystem member, always using the more general term "Eurosystem".)

A: In this specific case we would agree that, for the CBPP3, counterparties could communicate that *the Eurosystem* had been buying, but *not* the exact amounts, the securities involved or which Eurosystem member.

Q6.2: Where on the ECB's website can I find a list of the Eurosystem's current holdings of asset-backed securities and covered bonds?

A: Information on CBPP3 holdings can be found at <http://www.ecb.europa.eu/mopo/liq/html/index.en.html#portfolios>

Q6.3: It seems that one of the purposes of the CBPP3 is to get EU banks to originate more loans that go into asset-backed securities and covered bond structures and therefore, by buying the primary and secondary supply, provide the incentive to build a new market. Is this a fair comment?

A: In the case of covered bonds, net supply has been negative owing to low new issuance since 2013. The CBPP3 could trigger more primary issuance if interested issuers find the issuance levels attractive.

Q6.4: Will the Eurosystem act as a "regular" investor when conducting purchases under the CBPP3?

A: The Eurosystem will be purchasing covered bonds at prevailing market prices or, in the case of retained bonds, at prices that take into appropriate consideration all embedded risks.

Q6.5: Banks in some countries do not issue covered bonds and do not own asset-backed securities. How will the ECB help those banks if they do not own securities that the ECB is willing to purchase in the next couple of years?

A: Even if the market is small/non-existent at the moment, the mere fact that the Eurosystem is willing to buy asset-backed securities and covered bonds could encourage banks from these jurisdictions to issue such instruments.

Q6.6: The CBPP3 will increasingly crowd-out private sector investors, unless the new supply of eligible bonds rises substantially. Along this line, the covered bond market has no structural deficiencies and is thus clearly not in need of yet another ECB purchase programme. *Why have you nevertheless decided to buy covered bonds?*

A: Covered bonds have some features that are important from a monetary policy perspective. First, the link that is established on the issuing bank's balance sheet between the covered bond, on the one hand, and the loans that back the covered bond, on the other, is reasonably tight. As the prices for covered bonds increase, we expect banks to respond by originating more covered bonds and thus more loans to collateralise them. Second, outright interventions in this market will complement other purchases by reinforcing the portfolio rebalancing channels of monetary policy transmission and generating positive spillovers into other markets and securities. This will further ease funding and credit conditions. Third, taken together, the Eurosystem's non-conventional measures should be seen as complementary to one another, strengthening the combined impact on liquidity and the economy. Finally, purchases take due account of market functioning.

Q6.7: Why did you switch from a daily publication of covered bond purchases to a weekly one?

A: The ECB decided to harmonise publication practices regarding the different monetary policy portfolios. In particular, for the covered bond purchase programmes and the Asset-Backed Securities Purchase Programme, it was decided to adopt the publication practices already in place for the Securities Markets Programme to ensure greater consistency. The weekly publication of the settled amounts is in line with the medium-term objectives of the programmes and is consistent with the weekly release of the Eurosystem financial statement.

Q6.8: Could the Eurosystem have preferred creditor status for the CBPP3?

A: There is no legal basis on which the ECB could either claim or enforce preferred creditor status in the event of a default on covered bonds it has purchased under the CBPP3. That said, covered bonds qualify as senior secured debt, which is explicitly exempt, under Article 38(1)(b) of the Bank Recovery and Resolution Directive, from any bail-in measure in the event of bank resolution.