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(Resolutions, recommendations and opinions)

OPINIONS

EUROPEAN CENTRAL BANK

OPINION OF THE EUROPEAN CENTRAL BANK

of 6 August 2010

on a proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies

(CON/2010/65)

(2010/C 223/01)

Introduction and legal basis

On 12 November 2009, the European Central Bank (ECB) issued Opinion CON/2009/94 ⁽¹⁾ on the proposal for a Directive of the European Parliament and of the Council amending Directives 2006/48/EC and 2006/49/EC as regards capital requirements for the trading book and for re-securitisations, and the supervisory review of remuneration policies (hereinafter the 'proposed directive'). On 7 July 2010, the European Parliament adopted the proposed directive ⁽²⁾, which is now subject to the Council of the European Union's formal adoption. This opinion is based on the version of the proposed directive adopted by the European Parliament.

The ECB's competence to deliver an opinion is based on the last paragraph of Article 127(4) of the Treaty on the Functioning of the European Union, according to which the ECB may submit opinions, inter alia, to the appropriate Union institutions on matters in its fields of competence. In this respect, the proposed directive contains provisions affecting the European System of Central Banks' (ESCB) task to define and implement the monetary policy of the Union, as referred to in the first indent of Article 127(2) of the Treaty and the ESCBs' contribution to the smooth conduct of policies relating to the stability of the financial system, as referred to in Article 127(5) of the Treaty. 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. General observations

- 1.1. The ECB is concerned about the extension of the waiver for exposures in the form of covered bonds ⁽³⁾, collateralised by loans secured by residential and commercial real estate, contained in Annex I, paragraph 2(c)(ii) to the proposed directive. The extension of the waiver from 31 December 2010 to 31 December 2013 allows unlimited use of senior units issued by securitisation entities securitising residential and commercial real estate exposures in the cover pool of

⁽¹⁾ OJ C 291, 1.12.2009, p. 1.

⁽²⁾ P7_TA-PROV (2010) 0274.

⁽³⁾ As defined in Article 22(4) of Directive 85/611/EEC of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 375, 31.12.1985, p. 3).

covered bonds. Moreover, the adopted text removes the reference to the most favourable credit quality required for these units ⁽¹⁾.

- 1.2. The proposed directive, thus, affects UCITS-compliant covered bonds and asset-backed securities (ABSs) eligible for Eurosystem credit operations, as laid down in Guideline ECB/2000/7 of 31 August 2000 on monetary policy instruments and procedures of the Eurosystem ⁽²⁾. In this respect, the Eurosystem's collateral framework imposes a stricter treatment from a risk management perspective, e.g. higher haircuts and rating requirements, on ABSs compared to UCITS-compliant covered bonds. A possible consequence of the proposed directive could be to provide strong incentives for monetary policy counterparties to package their ABSs into the cover pool of such covered bonds, thereby obtaining more favourable treatment, to the detriment of the Eurosystem's risk exposure.
- 1.3. At the same time, and without prejudice to the ECB welcoming regulatory steps which mitigate the reliance of legislation on external ratings, the ECB has some concerns about the removal of the reference to the most favourable credit quality required for these units, as this could further undermine the credibility and transparency of the covered bonds market and, ultimately, have consequences for financial stability.
- 1.4. In general, the aim for the regulators in the near future should be to remove the waiver and develop a rigorous set of criteria for assets to be included in the cover pool of covered bonds which: (i) does not rely on external ratings; and (ii) is strong enough to secure market confidence in covered bonds, while allowing financial institutions sufficient time to adjust their respective business models. The reduction of the limit of the nominal amount of the outstanding issue from 20 % to 10 %, contained in Annex I, paragraph 2(c)(i) and (ii) to the proposed directive, can be seen as a positive movement in this direction.

2. Drafting proposals

Where the ECB recommends that the proposed directive is amended, specific drafting proposals are set out in the Annex accompanied by explanatory text to this effect.

Done at Frankfurt am Main, 6 August 2010.

The President of the ECB

Jean-Claude TRICHET

⁽¹⁾ See Annex VI, point 68(3) to 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 (recast) (OJ L 177, 30.6.2006, p. 1).

⁽²⁾ OJ L 310, 11.12.2000, p. 1.

ANNEX

Drafting proposals

Text proposed by the European Parliament	Amendments proposed by the ECB ⁽¹⁾
Amendment	
Annex VI, point 68(ii)	
<p>(ii) the third paragraph is replaced by the following:</p> <p>“Until 31 December 2013, the 10 % limit for senior units issued by French Fonds Communs de Créances or by equivalent securitisation entities as specified in points (d) and (e) does not apply, provided that: (i) the securitised residential or commercial real estate exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for covered bonds; and (ii) a member of the same consolidated group of which the issuer of the covered bonds is also a member or an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated retains the whole first loss tranche supporting those senior units. Before the end of this period, and by 31 December 2012 at the latest, the Commission shall review the appropriateness of this delegation and, if relevant, the appropriateness of extending similar treatment to any other form of covered bond. In the light of that review, the Commission may, if appropriate, adopt delegated acts in accordance with the power referred to in Article 151a to extend this period or make this delegation permanent or extend it to other forms of covered bonds.”</p>	<p>(ii) the third paragraph is replaced by the following:</p> <p>“Until 31 December 2013, the 10 % limit for senior units issued by French Fonds Communs de Créances or by equivalent securitisation entities as specified in points (d) and (e) does not apply, provided that: (i) those senior units have a credit assessment by a nominated ECAI, which is the most favourable category of credit assessment made by the ECAI in respect of covered bonds; (ii) the securitised residential or commercial real estate exposures were originated by a member of the same consolidated group of which the issuer of the covered bonds is also a member or by an entity affiliated to the same central body to which the issuer of the covered bonds is also affiliated (that common group membership or affiliation to be determined at the time the senior units are made collateral for covered bonds); and (iii) a member of the same consolidated group of which the issuer of the covered bonds is also affiliated retains the whole first loss tranche supporting those senior units. Before the end of this period, and by 31 December 2012 at the latest, the Commission shall review the appropriateness of this delegation and, if relevant, the appropriateness of extending similar treatment to any other form of covered bond. In the light of that review, the Commission may, if appropriate, adopt delegated acts in accordance with the power referred to in Article 151a to extend this period or make this delegation permanent or extend it to other forms of covered bonds.””</p>

Explanation

For the reasons set out in this opinion, the ECB has some concerns about the removal of the requirement for senior units to have the most favourable category of credit assessment made by a nominated external credit assessment institution (ECAI), as this could further undermine the credibility and transparency of the covered bonds market. For this reason, the ECB advises a reinsertion of the requirement. However, the aim for the near future should be to remove the waiver and develop a rigorous set of criteria for assets to be included in the cover pool of covered bonds which (i) does not rely on external ratings; and (ii) is strong enough to secure market confidence in covered bonds. Therefore, any reference to a potential (indefinite) extension of the waiver should be deleted.

The ECB is aware that Annex VI, point 68(i) requires that the senior units being used as collateral qualify for the credit quality step 1. However, this does not alleviate the concern about the removal of the requirement for senior units to have the most favourable category of credit assessment made by a nominated ECAI. This is due to the fact that the requirement for the quality step 1 only applies in respect of the 10 % limit for the nominal amount of the outstanding issue applicable where the waiver is not activated. In this respect, it is noted that the credit quality steps 1 to 6 are to be determined by the competent authorities in accordance with Article 82 of Directive 2006/48/EC, which implies a certain discretion in terms of credit quality. The ECB however understands the concept of ‘most favourable category of credit assessment’ to be more narrowly defined.

In the version of the proposed directive adopted by the European Parliament, the waiver can be applied subject to two requirements. The first requirement is that the securitised residential or commercial real estate exposures were not originated outside the group structure which the issuer of the covered bonds also belongs to. The ECB considers that this requirement may be difficult to verify in practice. The second requirement is that a member of the very same group structure retains the whole first loss tranche supporting those senior units. In the ECB’s view, even if the first loss tranche is being retained within the group, entities may easily circumvent

Text proposed by the European Parliament	Amendments proposed by the ECB ⁽¹⁾
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this requirement by using hedging strategies. For these reasons, the ECB does not consider that these requirements in themselves provide sufficient safeguards, which would warrant the inclusion of these assets in the cover pool of covered bonds. However, the ECB recognises that the requirements do provide a certain degree of protection for bondholders, especially if coupled with the reinsertion of the reference to the most favourable credit quality required for the senior units.

⁽¹⁾ Bold in the body of the text indicates where the ECB proposes inserting new text. Strikethrough in the body of the text indicates where the ECB proposes deleting text.
