EUROPEAN CENTRAL BANK

EUROSYSTEM

OPINION OF THE EUROPEAN CENTRAL BANK

of 14 June 2010

on amendments to the Law on covered bonds (*Pfandbriefe*)

(CON/2010/47)

Introduction and legal basis

On 6 April 2010, the European Central Bank (ECB) received a request from the German Federal Ministry of Finance for an opinion on a draft law on the implementation of the amended 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)[1] (hereinafter referred to as the 'Banking Directive') and of the amended Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (recast)[2] (hereinafter the 'Capital Adequacy Directive') (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, fifth 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[3], as the draft law relates to the Deutsche Bundesbank, to payment and settlement systems and to rules applicable to 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

The draft law is principally aimed at implementing the amendments to the Banking Directive and the Capital Adequacy Directive[4], as well as Directive 2009/44/EC[5]. Independently of this, the draft law

1 OJ L 177, 30.6.2006, p. 1.

2 OJ L 177, 30.6.2006, p. 201.

3 OJ L 189, 3.7.1998, p. 42.

4 Concerning uniform principles for the recognition of hybrid capital elements as core capital, regulations for securitisations and re-securitisations and more stringent requirements for disclosure, a change in the large exposures regime for better inclusion of concentration risks and a strengthening of cooperation between the national supervisory authorities in the European Economic Area.

5 Directive 2009/44/EC of the European Parliament and of the Council of 6 May 2009 amending Directive 98/26/EC on settlement finality in payment and securities settlement systems and Directive 2002/47/EC on financial collateral arrangements as regards linked systems and credit claims (OJ L 146, 10.6.2009, p. 37).

updates the Law on covered bonds (*Pfandbriefe*) in three main respects. First, it aims to strengthen the legal status of cover pools (and the *Pfandbrief* liabilities attaching to them with top priority) as organisations in their own right – distinct from the insolvent estate of a bank dealing in covered bonds (*Pfandbrief* bank). Second, it seeks to clarify the supervisory status of cover pools as licensed banks, since they may have activities requiring a licence. Third, it further strengthens the powers of cover pool administrators (*Sachwalter*) who may take all actions necessary to ensure the proper servicing of outstanding *Pfandbriefe* – including entering into transactions for obtaining additional liquidity for this purpose.

The cover pools (*Deckungsmasse*) for the *Pfandbriefe* consist of loans and securities fulfilling statutory requirements, entered in a special register, for the sole purpose of safeguarding the liquidation of issued *Pfandbriefe*. Legally, cover pools do not form part of the insolvent estate of the *Pfandbrief* bank. Cover pool assets are thus kept separate from the insolvent estate and from other cover pools.

A fundamental review of the legislation on *Pfandbriefe* was undertaken in 2004, introducing the role of the cover pool administrator who, upon appointment on a proposal of the Federal Financial Supervisory Authority (*BaFin*) must either (i) seek a sale of the cover pool, or (ii) secure the ongoing existence of the cover pool as a stand alone body for the purpose of properly servicing outstanding *Pfandbriefe*. For the latter situation, cover pool administrators were given wide-ranging powers to represent the pool and were mandated by law to take any action necessary to ensure the servicing of the – unaltered – *Pfandbriefe*. The legal entity carrying the cover pool was (and still is) the *Pfandbrief* bank.

Under the draft law, the cover pools will assume the legal nature of a '*Pfandbrief* bank with limited business activities'. In order to fully satisfy *Pfandbrief* creditors, as set out in the draft law, cover pool administrators shall represent their *Pfandbrief* bank with limited business activities (i.e. the cover pool) and their powers shall be clarified to enable them to take out loans and, exceptionally, also issue bonds for funding purposes, in particular to offset temporary shortfalls in liquidity. Cover pool administrators may issue these bonds as *Pfandbriefe*. Similarly, under the draft law, existing banking licences will continue in force with regard to the *Pfandbrief* banks with limited business activities. According to the explanatory memorandum, the continuation of a *Pfandbrief* bank is justified as long as the cover pools of the individual *Pfandbriefe* have the necessary assets, which is assumed to be the case due to the special protective mechanisms of the Law on *Pfandbriefe*. Only if the solvency of a *Pfandbrief* bank with limited business activities becomes doubtful will the supervisory authority be empowered to also revoke the licence of the *Pfandbrief* bank with limited business activities.

Finally, the draft law clarifies that the assets of a *Pfandbrief* bank held with Eurosystem central banks for the purpose of fulfilling the minimum reserve obligations, to the extent the latter are related to *Pfandbrief* liabilities, do not form part of the insolvent estate but belong to the *Pfandbrief* bank with limited business activities.

2. General observations

2.1 The ECB welcomes the draft law, as it provides for a procedure for insolvent banks to make appropriate separate settlements of German *Pfandbriefe* outside the scope of insolvency provisions and enables the cover pool administrator to ensure the complete settlement of outstanding *Pfandbriefe*.

2.2 The ECB welcomes that the third and fourth sentences of Section 30 (1) of the draft law regulate the continued existence of *Pfandbrief* banks and their purposes. The ECB notes that the draft law implicitly states that the activities of cover pool administrators, as well as the licence for the cover pool, will expire as soon as the servicing of outstanding *Pfandbriefe* is completed. However, given the option of issuing new *Pfandbriefe*, the ECB recommends further clarifying this.

2.3 The ECB stresses that it is entirely within the competence of the Eurosystem to decide what collateral and which counterparties to accept for the purposes of its monetary policy operations and intraday credit and to set criteria for participation in payment and clearing systems. National law cannot determine the eligibility of certain entities as monetary policy counterparties of the Eurosystem or the eligibility of certain assets as collateral within the monetary policy framework of the Eurosystem. The ECB notes that the draft law does not contain any explicit reference indicating that the administrator of an insolvent *Pfandbrief* bank's cover pool can obtain liquidity from the Eurosystem. However, the ECB would nevertheless recommend that this point is clarified and would welcome it if the explanatory memorandum were to reaffirm that it is for the Eurosystem alone to decide the eligibility criteria for counterparties and assets.

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

Done at Frankfurt am Main, 14 June 2010.

[signed]

The President of the ECB

Jean-Claude TRICHET