



EUROPEAN CENTRAL BANK

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OPINION OF THE EUROPEAN CENTRAL BANK

of 8 September 2017

on the legal framework for covered bonds, reporting of credit data, macroprudential powers and tools, and SSM common procedures

(CON/2017/36)

Introduction and legal basis

On 12 July 2017 the European Central Bank (ECB) received a request from the Ministry of Finance of the Slovak Republic for an opinion on a draft law amending the Law on banking and certain other laws (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, fourth and sixth indents of Article 2(1) of Council Decision 98/415/EC¹, as the draft law relates to Národná banka Slovenska, the collection, compilation and distribution of monetary, financial, banking, payment systems and balance of payments statistics, rules applicable to financial institutions insofar as they materially influence the stability of financial institutions and markets and the ECB's specific tasks concerning the prudential supervision of credit institutions pursuant to Article 127(6) 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. Purpose of the draft law

- 1.1 The main purpose of the draft law is to comprehensively reform the existing system of mortgage bank financing in Slovakia, which is based on mortgage bonds, with the aim of replacing mortgage bonds with covered bonds.
- 1.2 The draft law contains a number of detailed provisions relating to covered bonds.
 - (a) It defines the institutions allowed to issue covered bonds, i.e. only banks established in Slovakia.
 - (b) It outlines additional authorisation procedures in the form of prior approval by Národná banka Slovenska (NBS) concerning covered bond issuers to perform activities related to the covered bond programme.
 - (c) It specifies the legal status of covered bonds and the types of assets eligible for inclusion in the cover pool. These assets include: (i) mortgage loans with a maximum maturity of 30 years, provided to consumers, secured by mortgages over real estate and registered in the covered

¹ Council Decision 98/415/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions (OJ L 189, 3.7.1998, p. 42).

bond register. These mortgage loans must represent at least 90% of the total value of the cover pool; (ii) substitution assets; (iii) hedging derivatives; and (iv) liquid assets.

- (d) It sets out the valuation, composition and structure of the cover pool. A bank that is a covered bond issuer must ensure the quality of the cover pool throughout the entire lifetime of the covered bonds by monitoring and updating the valuation of the collateral assets and the corresponding loan-to-value (LTV) calculations. The relevant covered bonds programme administrator must confirm whether pool assets meet specified eligibility criteria. For a single loan secured by a mortgage, the LTV ratio may not be higher than 80% at the time of registration in the covered bonds register. If the LTV ratio exceeds 80% due to a decrease in the value of the property securing that loan, the loan may remain in the cover pool, as long as only up to 80% of the value of the property is taken into account in the calculation of the coverage requirement. In the event that the property value falls to a level below the outstanding amount of the loan, the bank is required to remove the corresponding mortgage loan from the covered bonds register.
 - (e) It establishes the covered bonds register. Under this provision, the bank that is a covered bond issuer registers the cover pool, the issued covered bonds and the bank's liabilities relating to the covered bonds issued. The bank also has an obligation to keep separate bookkeeping records on covered bonds and assets in the cover pool.
 - (f) It sets out the rules regarding the issuance and supervision of covered bonds, including the powers of covered bond programme administrators.
 - (g) It defines covered bondholders' rights.
 - (h) It stipulates special provisions in the event of an issuer's insolvency or bankruptcy.
 - (i) It defines transparency requirements.
- 1.3 The draft law protects covered bondholder's rights, granting them a priority security right over the assets forming the cover pool. These rights ensure that their claims against a bank issuing covered bonds can be preferentially secured, with a view to ensuring adequate and timely service of covered bondholders in the event of an issuer's insolvency². The draft law also sets up a procedure to prolong the maturity of liabilities under covered bonds in certain circumstances. This includes when an authorised person in the interests of the bank, covered bondholders and mortgage lenders intends to transfer the covered bond programme to another bank or banks due to insolvency, forced administration, resolution or bankruptcy proceedings. The procedure is valid for one year from the date the authorised person notifies NBS of that intention. The prior approval of NBS is required to transfer a covered bond programme to another credit institution. Moreover, the draft law regulates the procedure on the insolvency of a credit institution for dealing with the separate estates of the secured creditors that are holders of covered bonds.

² The draft law amends, in this respect, the Law on bankruptcy and the Law on resolution. See Law No 7/2005 on bankruptcy and restructuring, as amended, and Law No 371/2014 on the addressing of crisis situations in the financial market, as amended.

- 1.4 The draft law seeks to ensure the provision of credit data required for the purposes of Regulation (EU) 2016/867 of the European Central Bank (ECB/2016/13)³. In anticipation of the obligations under Regulation (EU) 2016/867, the draft law extends the range of specific counterparties in respect of which data will be provided to the existing Bank Loan and Guarantee Register maintained by NBS. The draft law also allows for the exchange of information between NBS and the ECB on the basis of a written agreement. As a result of this exchange, the ECB will be entitled to use data on loans granted to business entities, data on collateral and liabilities related to these loans and other data on counterparties under Regulation (EU) 2016/867.
- 1.5 The draft law empowers NBS to introduce a debt-to-income (DTI) limitation based on the ratio between a borrower's overall indebtedness in respect of mortgage and consumer loans and the borrower's income. Information on income needs to be demonstrably verified by means of internal or external sources that are independent of the borrower. The draft law sets out the legal basis for designing the DTI as a new tool that extends the current macroprudential toolkit in Slovakia and forms an integral part of assessing the creditworthiness of consumers who are mortgage borrowers or credit debtors. This tool is intended to apply in the case of loans provided by banks, branches of foreign banks and other creditors.
- 1.6 The draft law introduces a number of reforms relating to consumer credit or mortgage loans. These provide, inter alia, that, in the event of unexpected financial difficulties on the part of a consumer, banks or creditors may extend the maturity of the loan up to a maximum of six months, and oblige creditors to verify information on a consumer's current income using external sources.
- 1.7 The draft law amends the relevant provisions of the Law on supervision⁴, mainly concerning proceedings before NBS and its supervision over the financial market. The draft law also aims to ensure that the annual contributions by supervised entities are set more fairly, with a more reasonable distribution of the associated financial burden among the relevant supervised entities in the financial market.
- 1.8 The draft law provides that the Law on supervision will also apply *mutatis mutandis* to NBS procedures in the provision of cooperation and preparation of materials to assist the ECB in the exercise of its tasks and decision-making under the Single Supervisory Mechanism (SSM)⁵. As noted in the explanatory memorandum accompanying the draft law, current procedural practices, where the competent supervisory authority is the ECB in accordance with Regulation (EU) No 1024/2013, in conjunction with Regulation (EU) No 468/2014, demonstrate a need for proportionality in the application of the provisions governing supervisory action, where NBS assesses the application and draws up a draft decision for the ECB. The draft law further provides

³ Regulation (EU) 2016/867 of the European Central Bank of 18 May 2016 on the collection of granular credit and credit risk data (ECB/2016/13) (OJ L 144, 1.6.2016, p. 44).

⁴ Law No 747/2004 Coll. on financial market supervision.

⁵ See Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63), in conjunction with Regulation (EU) No 468/2014 of the European Central Bank of 16 April 2014 establishing the framework for cooperation within the Single Supervisory Mechanism between the European Central Bank and national competent authorities and with national designated authorities (SSM Framework Regulation) (ECB/2014/17) (OJ L 141, 14.5.2014, p. 1).

that if cooperation is required for a decision under the SSM, NBS must take its decision no later than 18 months after the request, unless a different time limit for the decision is provided for in a separate regulation.

- 1.9 Finally, the draft law makes provision in Slovak law for the future powers of intervention that NBS will acquire from 1 January 2018 under Regulation (EU) No 1286/2014 of the European Parliament and of the Council⁶ and from 3 January 2018 under Regulation (EU) No 600/2014 of the European Parliament and of the Council⁷.

2. Preliminary comment

This opinion focuses on the provisions of the draft law relating to (a) the tasks of NBS; (b) the new legal framework for covered bonds; (c) the reporting of credit data by way of implementation of Regulation (EU) 2016/867; (d) the use of DTI for financial stability purposes, enlarging the macroprudential toolkit in Slovakia; and (e) NBS procedural rules, including in the context of SSM common procedures.

3. Tasks of NBS

- 3.1 The provisions of the draft law relating to the new powers of NBS do not extend the current supervisory and macroprudential mandate of NBS. It is already the national authority competent for financial market supervision⁸, as well as the macroprudential authority in Slovakia⁹. NBS also has the supervisory and macroprudential powers necessary to fulfil these functions.
- 3.2 From the perspective of the tasks to be carried out by NBS, the powers related to the authorisation and supervision of the issuance of covered bonds are not intrinsically distinct from NBS's existing powers with respect to the authorisation of mortgage transactions, including the issuance of mortgage bonds¹⁰. Similarly, the product intervention powers mirroring those introduced under Union regulations in the field of financial instruments are akin to supervisory powers that NBS already exercises over the activities of financial market participants¹¹. Further, the power to introduce a DTI limitation for financial stability purposes is not fundamentally distinct from the power of NBS to introduce other macroprudential tools.
- 3.3 It follows that the draft law does not confer genuinely new tasks on NBS, but rather specifies certain new powers that NBS may use when carrying out the same category of tasks already

⁶ See Article 17 of Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs) (OJ L 352, 9.12.2014, p. 1).

⁷ See Article 42 of Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 (OJ L 173, 12.6.2014, p. 84).

⁸ See Article 1 of the Law on supervision.

⁹ See Article 1 of the Law on supervision, in conjunction with Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (OJ L 331, 15.12.2010, p. 1).

¹⁰ See Article 6 of Law No 483/2001 Coll. on banks, in conjunction with Article 1 of the Law on supervision.

¹¹ See Article 135 of Law No 566/2001 Coll. on securities and investment services, in conjunction with Article 1 of the Law on supervision.

discharged by NBS under its supervisory and macroprudential responsibilities. Consequently, the issue of assessing whether the conferral of new tasks on a national central bank complies with the prohibition of monetary financing does not arise in the case at hand.

4. Covered bonds law reform

- 4.1 The ECB welcomes the draft law's introduction of a new legal regime for covered bonds, taking into account the best practices identified by the European Banking Authority (EBA)¹², which aims to modernise existing Slovak regulations, contribute to the development of the Slovak capital market and improve the level of protection and legal certainty for investors. In particular, the ECB welcomes the draft law's objective to ensure that covered bonds issued under the draft law are financial instruments of good quality and that they provide a suitable and effective source of long-term funding, supporting banks' business models and overall stability.
- 4.2 The European Commission has announced that it will put forward a legislative proposal for a Union framework on covered bonds to help banks finance their lending activity scheduled for the first quarter of 2018¹³. The ECB favours a high-quality and transparent covered bond market in the Union, and sees potential for harmonising certain standards and practices.
- 4.3 The draft law also introduces a disclosure obligation for banks with respect to covered bond programmes, which seeks to ensure that banks inform the public about the issuance of covered bonds in a transparent manner. This disclosure obligation is one of the requirements that a covered bond must meet in order to be considered, in portfolios of banks that have purchased covered bonds, an exposure with a preferential risk weight in line with Article 129(6) of Regulation (EU) No 575/2013 of the European Parliament and of the Council¹⁴. In particular, the ECB welcomes the fact that under the draft law documents related to the covered bond programme must be made available as part of the disclosure obligation, although it would be helpful to specify which transaction documents must be disclosed. The transparency requirements of Article 129(7) of Regulation (EU) No 575/2013 are minimum requirements and national legislative bodies are encouraged to ensure that the disclosure obligation is in line with best market practices, allowing adequate due diligence to be performed.
- 4.4 The ECB welcomes the draft law's proposed introduction of a requirement for a liquidity buffer to address liquidity risk. The ECB agrees that this liquidity buffer should be segregated as part of the cover pool assets and understands that these liquid assets may be counted towards the fulfilment of the liquidity coverage ratio. However, it does not appear prudent to apply a coefficient of only 0.4 to negative cash flows related to principal payments occurring within 31-180 days. The Slovak

¹² See the EBA Report on Covered Bonds: Recommendations on harmonisation of covered bond frameworks in the EU of 20 December 2016 (EBA-Op-2016-23), available on the EBA's website at www.eba.europa.eu.

¹³ See the European Commission's Initiative on an integrated covered bond framework (Inception Impact Assessment) of 9 June 2017, available on the Commission's website at www.ec.europa.eu.

¹⁴ 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 648/2012 (OJ L 176, 27.6.2013, p. 1).

- authorities are encouraged to ensure that those cash flows are taken fully into account for the purposes of calculating such liquidity requirements.
- 4.5 The draft law proposes that the maturity date of covered bonds can be extended by a maximum of 12 months only if: (a) forced administration is imposed on the bank that issues the covered bonds; (b) a resolution procedure has been initiated and conducted; or (c) the bank has been declared bankrupt.
- 4.6 The ECB welcomes the fact that the draft law does not set an upper limit for the coverage indicator, i.e. the value of the cover pool over the value of the outstanding liabilities. The draft law specifies that a bank that is an issuer of covered bonds must maintain the mandatory coverage indicator at 105% or such higher coverage indicator as is specified in the individual issue conditions for the covered bonds. Since, in practice, it may be difficult to maintain the coverage indicator precisely at 105%, the draft law could be reworded to require the issuer to maintain a mandatory coverage indicator of at least 105%. The ECB welcomes the possibility for a bank that is an issuer of covered bonds to maintain a higher coverage indicator in the individual issue conditions for the covered bonds, which, according to the draft law, needs to be maintained until the respective bond has been redeemed in full.

5. Provisions supporting reporting of credit data under Regulation (EU) 2016/867

- 5.1 The draft law seeks to ensure the provision of credit data required for the purposes of Regulation (EU) 2016/867. The ECB welcomes the fact that the draft law enables NBS, as the sole operator of the information exchange system, to make special agreements with regard to linking the information exchange system with comparable databases established in other Member States.
- 5.2 The ECB welcomes the fact that the draft law extends the range of counterparties and enables the system of electronic exchange of information between NBS and the ECB to be developed, facilitating credit risk assessment, thereby enhancing risk management capabilities. These new or improved statistics to be produced in the long term are necessary for the performance of Eurosystem tasks, including monetary policy analysis, monetary policy operations, risk management, financial stability surveillance and research, as well as the Eurosystem's contribution to the smooth conduct of policies pursued by the competent authorities relating to the prudential supervision of credit institutions and the stability of the financial system. These data will also be useful for banking supervision purposes in the context of the SSM¹⁵.
- 5.3 The draft law provides for NBS to collect credit data without any threshold at national level. Where the data meets the reporting threshold in Article 5(1) of Regulation (EU) 2016/867¹⁶, it will be reported to the ECB in accordance with that Regulation.

¹⁵ See paragraph 3.2.5.2 of Opinion CON/2016/42. All ECB opinions are published on the ECB's website at www.ecb.europa.eu.

¹⁶ The reporting threshold under Article 5(1) of Regulation (EU) 2016/867 means that credit data must be reported for instruments specified in Article 4 thereof where the debtor's commitment amount is equal to or larger than EUR 25 000 on any reporting reference date within the reference period.

6. Macroprudential aspects of NBS setting the limit on the DTI ratio for consumer credit and mortgage loans

- 6.1 Household indebtedness has doubled in Slovakia since 2010¹⁷. The ECB would like to emphasise its stance on implementing macroprudential tools to foster a sound amortisation culture and to counteract excessive household indebtedness and financial imbalances¹⁸. Therefore, from a financial stability perspective, the ECB welcomes the fact that the draft law establishes a legal basis to limit the ratio of overall indebtedness to a borrower's income for mortgage loans and consumer credit.
- 6.2 The draft law empowers NBS to issue secondary legislation in the form of decrees, which can be used to set out this macroprudential instrument in more detail. The ECB expects NBS to consult the ECB in accordance with Article 127(4) of the Treaty on any such decrees related to the DTI¹⁹.

7. Procedural rules at NBS, including in the context of SSM common procedures

- 7.1 Under the draft law, the detailed provisions of Slovak law relating to proceedings in supervisory matters will apply *mutatis mutandis* to NBS procedures effected under the common procedures for cooperation with regard to an application for an authorisation to take up the business of a credit institution, the withdrawal of an authorisation and the acquisition of qualifying holdings under Regulation (EU) No 468/2014²⁰.
- 7.2 These changes should optimise these proceedings and increase legal certainty for all parties concerned. These changes do not seek to interfere in any way with ECB decision making processes within the framework of the SSM.

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

Done at Frankfurt am Main, 8 September 2017.

[signed]

The President of the ECB

Mario DRAGHI

¹⁷ See the explanatory memorandum to the draft law detailing amendments to Law No 129/2010 Coll. on consumer credits and other credits and loans for consumers and Law No 90/2016 Coll. on housing loans.

¹⁸ See paragraph 2.1 of Opinion CON/2016/18 and paragraph 2.1 of Opinion CON/2017/14.

¹⁹ See paragraphs 2.3 and 2.4 of Opinion CON/2017/11.

²⁰ The common procedures are set out in Articles 73 to 88 of Regulation (EU) No 468/2014.