EBA/Op/2014/13

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Opinion of the European Banking Authority on the partial waiver of Article 129(1)(c) of the CRR

Introduction and legal basis

The EBA competence to deliver an opinion is based on Article 29(1)(a) of Regulation (EU) No 1093/2010[1], which relates to the EBA's area of competence by virtue of Article 129(1) third subparagraph of Regulation (EU) No 575/2013 (CRR)[2].

Article 129 of the CRR specifies the conditions for the eligibility of covered bonds in relation to risk weight preferential treatment, including the assets by which eligible covered bonds can be collateralised. Article 129(1)(c) specifies that eligible covered bonds can be collateralised by exposures to institutions that qualify for the credit quality step (CQS) 1 as specified in Part Three, Title II, Chapter 2 of the CRR. The total exposure of this type must not exceed 15% of the nominal amount of outstanding covered bonds of the issuing institution. Exposures to institutions in the Union with a maturity not exceeding 100 days shall not be comprised by the CQS 1 requirement but those institutions must at least qualify for CQS 2 as specified in Part Three, Title II, Chapter 2 of the CRR.

The third subparagraph of Article 129 specifies that the competent authorities may, after consulting the EBA, partially waive the application of Article 129(1)(c) and allow CQS 2 for up to 10% of the total exposure of the nominal amount of outstanding covered bonds of the issuing institution. This applies only if significant potential concentration problems in the Member States concerned can be documented due to the application of the CQS 1 requirement referred to in that point.

On 8 May 2014, the Danish Financial Supervisory Authority (*Finanstilsynet* – Danish FSA) submitted to the EBA a proposal to partially waive Article 129(1)(c) of the CRR.

[1] Regulation (EU) No 1093/2010 of the European Parliament and of the Council of 24.11.2010 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).

[2] Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26.6. 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).

In accordance with Article 14(5) of the Rules of Procedure of the Board of Supervisors[3], the Board of Supervisors has adopted this opinion.

General comments

Having given consideration to:

a) the evidence provided by the Danish FSA on the current classification of Danish credit institutions in relation to the CQSs assigned on the basis of external credit ratings, whereby only one Danish credit institution currently classifies as a CQS 1;

b) the evidence provided by the Danish FSA on the current composition of the Danish covered bond market and on the characteristics of the Danish covered bond regime;

c) the evidence provided by the Danish FSA on the type and nature of exposures to credit institutions that covered bonds regularly assume;

the EBA is of the opinion that the Danish FSA has provided sufficient evidence to document a significant potential concentration problem in Denmark stemming from the application of the CQS 1 requirement specified in Article 129(1)(c) of the CRR. This has the potential to result in prudential concerns and concerns related to the degree of competition in the financial market. The EBA is therefore of the opinion that the establishment of a partial waiver is currently adequately justified.

Specific comments

Assessing a significant potential concentration problem

The EBA assesses the significant potential concentration problem within the jurisdiction that is submitting the notification of partial waiver and takes into account several factors, including but not limited to the following:

i. the nature of exposures to credit institutions that covered bonds assume in that jurisdiction;
ii. the magnitude of exposures to credit institutions that covered bonds assume in that jurisdiction;
iii. the number of credit institutions to which a CQS 1 is being assigned at the time of consideration by any of the External Rating Agencies registered/certified with ESMA (at least by any of the large/internationally active ECAIs);
iv. the scope of business activities of those credit institutions to which a CQS 1 is being assigned;
v. other potential jurisdiction-specific considerations related to institutions in that jurisdiction;
vi. potential additional eligibility conditions set by the national covered bond regime on exposures to credit institutions, beyond the CQS 1 criterion;

[3] Decision adopting the Rules of Procedure of the European Banking Authority Board of Supervisors of 11.12.2013 (Decision EBA/DC/001 (Rev 3)).

vii. an assessment of the expected impact of granting vs. not granting the partial waiver on Article 129(1)(c) of the CRR within the applicant jurisdiction;
viii. other general considerations, where appropriate.

The EBA considers several different forms of exposures to credit institutions that may arise within a covered bond programme, including but not limited to the following forms of exposures:

a) exposures arising from the use of account bank facilities;
b) exposures arising from derivative contracts entered into with credit institutions, i.e. where the credit institution is the counterparty of the covered bond issuer/covered bond programme within the derivative contract;
c) exposures arising from the use of instruments issued by credit institutions as substitution/complementary assets within the covered bond programme.

As part of the information provided by the national competent authority notifying the partial waiver, a clear illustration must be provided of the CRR provisions with which the exposures considered in the assessment of the concentration can be classified as exposures to credit institutions.

The concentration problem in Denmark

Based on the evidence provided by the Danish FSA, the EBA understands that covered bonds issued in the jurisdiction's regime may assume different exposures to credit institutions, including but not limited to the following circumstances:

i. covered bonds issuers temporarily place funds with credit institutions during loan refinancing operations or due to mismatches in the timing of mortgage payment inflows and bond redemptions;
ii. covered bonds issuers enter into derivative contracts with credit institutions to hedge currency and interest rate risks, as mandated by statutory requirements;
iii. covered bonds issuers make use of instruments issued by credit institutions as substitution assets, for risk management purposes and for covering rating agencies' over-collateralisation requirements and statutory requirements for additional collateral.

As documented by the Danish FSA, there currently exists only one credit institution (*Nordea Bank Danmark*) that has been assigned an external credit rating that qualifies it to be a CQS 1 credit institution (the list of Danish credit institutions with ECAI credit assessments is shown in Table 1 below).

Table 1 List of Danish credit institutions with ECAI credit assessments[4]

Credit institution	S&P	Moody's	Fitch
Danske Bank	A-	Baa1	A
FIH Erhvervsbank	n/a	B1*	n/a
Jyske Bank	A-	Baa1*	n/a
Nordea Bank Danmark	AA-	A1	AA-
Nykredit Bank	A+	Baa2*	A
Ringkjøbing Landbobank	n/a	Baa1	n/a
Sydbank	n/a	Baa1	n/a

According to evidence provided by the Danish FSA, in June 2014, seven covered bond issuers held outstanding covered bonds for a total nominal amount of approx. DKK 2.2 tn (approx. EUR 298 bn).

In the absence of a partial waiver, to achieve compliance with Article 129 of the CRR, covered bond programmes assuming exposures to credit institutions of the types mentioned in the previous sections would potentially need to rely on one single credit institution in the jurisdiction. Taking into account:

a. the documented size of the Danish covered bond market;

b. the fact that, in accordance with Article 129 of the CRR, each issuing institution may collateralise with exposures to credit institutions up to 15% of its outstanding covered bonds;

the potential exposure of all Danish covered bond issuers to one single eligible credit institution is deemed to result in an excessive concentration towards one single financial name and, consequently, to pose both prudential concerns and concerns related to the degree of competition of the financial market.

In addition, due to the presence of a single eligible (i.e. CQS 1) credit institution in the Danish financial market, it appears more likely that the exposure of covered bond programmes to credit institutions may be further constrained by the provisions of the CRR regulating large exposures.

As documented by the Danish FSA, 77 institutions currently exist in Denmark which are assigned a CQS on the basis of the CQS assigned to the Danish State, in accordance with Article 121 of the CRR. The Danish FSA also clarifies that, due to their limited capacity, these institutions are not in a

[4] Asterisk * indicates that the corresponding credit assessment is unsolicited.

position to meet the demand for exposures to credit institutions arising within the national covered bonds market.

As documented by the Danish FSA, some covered bond programmes currently assume, to a limited extent, exposures to credit institutions domiciled in two foreign jurisdictions (Norway and Sweden). However, the openness of the Danish covered bond market to exposures to foreign credit institutions is deemed limited, and not appropriate for meeting the overall outstanding demand for exposures to credit institutions.

Exercising the waiver

The EBA understands that the Danish FSA will make an executive order on the use of the waiver. The executive order will be published as legislation on the Danish FSA's homepage.

Review of the waiver's continued relevance

The Danish FSA will be monitoring the situation and evaluate the need for continuous use of the waiver every second year, using information that documents the concentration problem. The executive order will state that if the concentration problem is no longer significant, the measure will be repealed.

If use of the waiver is terminated, this will be communicated in the form of an executive order repealing the executive order granting the use of the waiver and will be issued in the same way.

Exposures to credit institutions qualifying as CQS 2, entered into while the executive order was in force, will be grandfathered, allowing the mortgage credit institutions and universal banks affected by termination of the use of the waiver sufficient time for a change in exposures.

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

Done at London, 17 December 2014

[signed]

Andrea Enria

Chairperson
For the Board of Supervisors