

| EBA/Op/2015/08 | |
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| 05 March 2015 | |

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 1093/2010¹, 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(1) 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 29 December 2014, the Swedish Financial Supervisory Authority (*Finansinspektionen* – FI) 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 Supervisors³, the Board of Supervisors has adopted this opinion.

General comments

Having given consideration to:

- a) the evidence provided by the Swedish Financial Supervisory Authority on the current classification of Swedish credit institutions in relation to the CQSs assigned on the basis of external credit ratings, whereby only two Swedish credit institutions currently classify as CQS 1;
- b) the evidence provided by the Swedish Financial Supervisory Authority on the current composition of the Swedish covered bond market and on the characteristics of the Swedish covered bond regime;
- c) the evidence provided by the Swedish Financial Supervisory Authority on the type and nature of exposures to institutions that covered bonds regularly assume;

the EBA is of the opinion that the Swedish Financial Supervisory Authority has provided sufficient evidence to document a significant potential concentration problem in Sweden 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 institutions that covered bonds assume in that jurisdiction;
- ii. the magnitude of exposures to 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 different forms of exposures to 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 bank account facilities;
- b) exposures arising from derivative contracts entered into with institutions, i.e. where the institution is the counterparty of the covered bond issuer/covered bond programme within the derivative contract;
- exposures arising from the use of instruments issued by institutions as substitution/complementary assets within the covered bond programme;
- d) exposures arising from the use of liquidity facilities.

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 institutions.

The concentration problem in Sweden

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

- i. covered bonds issuers temporarily place funds with institutions due to mismatches in the timing of mortgage payment inflows and bond redemptions;
- ii. covered bonds issuers enter into derivative contracts with institutions to hedge currency and interest rate risks, as mandated by statutory requirements⁴;
- iii. covered bonds issuers make use of instruments issued by 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 Swedish Financial Supervisory Authority, there are currently only four credit institutions that have been assigned an external credit rating that qualifies them to be CQS 1 credit institutions. The list of Swedish credit institutions with ECAI credit assessments is shown in

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⁴ The Swedish Financial Supervisory Authority's regulations and guidelines FFFS2013:1 regarding covered bonds specifies that covered bond issuers may only enter into derivative arrangements with a counterparty that, at the time that the agreement is entered into, has a publicly recognised credit rating from a qualified rating institution at a level no less than A-/A3 (chapter 4, section 8).

Table 1:



Table 1 List of Swedish credit institutions with ECAI credit assessments

| Credit institution | S&P | Moody's | Fitch |
|---|-----|---------|-------|
| Nordea Bank AB | AA- | Aa3 | AA- |
| Svenska Handelsbanken AB | AA- | Aa3 | AA- |
| Skandinaviska Enskilda Banken AB | A+ | A1 | A+ |
| Swedbank AB | A+ | A1 | A+ |
| SBAB Bank AB (publ) | Α | A2 | NR |
| Länsförsäkringar Bank Aktiebolag (publ) | Α | A3 | NR |
| Skandiabanken Aktiebolag (publ) | NR | A3 | NR |
| Kommuninvest i Sverige AB | AAA | Aaa | NR |
| Aktiebolaget Svensk Exportkredit | AA+ | Aa1 | NR |
| Landshypotek Bank Aktiebolag | A- | NR | A- |
| Volvofinans Bank AB | NR | Baa2 | NR |
| Länsförsäkringar Hypotek AB (publ) | AAA | Aaa | NR |
| Swedbank Hypotek AB | A+ | A1 | NR |
| Stadshypotek AB | NR | NR | AA- |
| Swedbank Sjuhärad AB | A- | NR | NR |

Of the four CQS 1 Swedish credit institutions, two of them, Kommuninvest i Sverige AB and Aktiebolaget Svensk Exportkredit, are specialist institutions with limited business models which do not extend to any activity involving taking credit exposure. Respectively:

- Kommuninvest i Sverige AB lends exclusively to Swedish municipalities; and
- Aktiebolaget Svensk Exportkredit operates as an export credit agency.

As documented by the Swedish Financial Supervisory Authority, there are currently 114 institutions in Sweden that are assigned a CQS on the basis of the CQS assigned to the Swedish State, in accordance with Article 121 of the CRR. The Swedish Financial Supervisory Authority also clarifies that, due to their limited capacity, these institutions are not in a position to meet the demand for exposures to institutions arising within the national covered bonds market.

As documented by the Swedish Financial Supervisory Authority, one covered bond programme currently assumes, to a limited extent, exposures to institutions domiciled in a foreign jurisdiction



(Germany). Otherwise, only credit institutions that are part of domestic banking groups act as counterparties in derivatives for Swedish covered bonds. The openness of the Swedish covered bond market to exposures to foreign credit institutions is deemed limited, and not appropriate for meeting the overall outstanding demand for exposures to institutions.

The EBA has also assessed whether non-Swedish institutions could act as eligible counterparties to a significant degree. Given that these issuers must have some knowledge of the Swedish market, foreign market makers for Swedish government securities were assessed for their potential eligibility as foreign counterparties. These institutions are likely to also provide financial services in the Swedish market, given that the securities are issued in the currency of the issuing state. There are currently seven institutions which are market makers, including three non-domestic institutions. Of the seven institutions two are classified as CQS 1: Nordea Bank AB (Nordea Markets) and Svenska Handelsbanken AB (Handelsbanken Markets). Therefore, no foreign counterparties currently fulfil the CQS 1 criteria.

According to evidence provided by the Swedish Financial Supervisory Authority, as of 30 September 2014, eight covered bond issuers have issued outstanding covered bonds for a total nominal amount of approximately SEK 1.8 tn (approx. EUR 195 bn).

These issuers enter into derivative contracts with credit institutions for the purpose of hedging currency and interest rate risks. Swedish mortgage loan products typically feature short-term fixed rates. The derivative exposures are significant and in aggregate amounted to SEK 873 bn⁵ (approximately EUR 95 bn) as of Q3 2014.

In the absence of a partial waiver, to achieve compliance with Article 129 of the CRR, covered bond issuers/programmes assuming exposures to institutions of the types mentioned in the previous sections would potentially need to rely on only two credit institutions in the jurisdiction. This also implies that the covered bond issuers/programmes within the jurisdiction may be more likely to breach the limits imposed by the CRR requirements on large exposures in relation to the names of the two institutions eligible to act as counterparties.

Taking into account:

a. the documented size of the Swedish 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 Swedish covered bond issuers to two eligible credit institutions is in the view of the EBA likely to result in an excessive concentration towards two financial names

⁵ This figure represents the net absolute notional amount for each issuer. SEK 328 bn (approximately EUR 36 bn) in currency derivatives and SEK 545 bn (approximately EUR 59 bn) in interest rate derivatives.



and, consequently, to pose both prudential concerns and concerns related to the degree of competition in the Swedish financial market.

Exercising the waiver

The EBA understands that the Swedish Financial Supervisory Authority will amend its Regulatory Code, FFFS 2014:12 regarding prudential requirements and capital buffers. A new paragraph will be added which will state that 'Exposures pursuant to Article 129(1)(c) of the CRR may, for the fulfilment of the requirements in Article 129(1) of the CRR, consist of exposures to institutions that qualify for the credit quality step 2. The total exposure of this kind shall not exceed 10% of the nominal amount of outstanding covered bonds of the issuing institution'.

Review of the waiver's continued relevance

The Swedish Financial Supervisory Authority commits to monitoring the situation and evaluating the need for the continued use of the partial waiver on an annual basis, using information that documents the concentration problem. If the concentration problem is no longer significant, the partial waiver will be repealed.

In the event of a revocation of the waiver, the treatment of exposures to CQS 2 institutions included in the cover pool, will depend on the circumstances at the time of the revocation. The Swedish Financial Supervisory Authority will act prudently in accordance with its objective of strengthening the financial stability in Sweden.

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

Done at London, DD Month YYYY

[signed]

Andrea Enria

Chairperson

For the Board of Supervisors