ABI Associazione Bancaria Italiana

Banche Assicurazioni Finanza

Italian Banking Insurance and Finance Federation

European Commission's Consultation Document on Covered Bonds in the European Union

Contribution to the Public Consultation by ABI, the Italian Banking Association,and FeBAF, the Italian Banking Insurance and Finance Federation

This contribution, prepared by ABI and FeBAF,represents the common point of view of the Italian banking industry and of the wider savings, insurance and finance community in Italy.

FeBAF in fact contributes also on behalf of its member organisations that represent Italy's main business associations in the field of investment and finance (see below).

It is our hope that this consultation will provide useful information and suggestions contributing thereby to the most effective and swift possible planning and implementation of the Capital Markets Union.We regard in fact the CMU as a fundamental pre-requisite for setting the financing of the real economy and investment on a stronger and more sustainable footing, and thereby leading to higher economic growth and employment in Europe.

We are strongly committed to a continuing dialogue and cooperation among our institutions and organisations, at the national and the international level, and remain open to providing further input, clarification and information if needed. For convenience, our e-mail address is: info@febaf.it.

ABI has the purpose to represent, defend and promote the interests of its member banks and financial intermediaries. It works, in this framework, for the development of the awareness in society and within the banking and financial system of the social and behavioral values that follow from entrepreneurial principles and from the formation of open and competitive markets.

FeBAF, active since 2008, aims at providing a 'common home' of savings and finance institutions in Italy. It includes among its members the Italian Banking Association (ABI), the Insurers' Association (ANIA), the Asset Management Industry Association (Assogestioni), and the Italian Private-Equity and Venture-Capital Association (AIFI). Aggregate members are the Fiduciary Services Association (Assofiduciaria), the Real-Estate Association (Assoimmobiliare), the Supplementary Pensions and Assistance Association (Assoprevidenza), and the Securities Brokerage Association (Assosim).

General Comments

- Well-developed product. Any reform should not impair existing programmes and existing issuances
- Structures are different from country to country, any Framework should allow the current different structural options to remain as they are according to each country specific legal framework without giving priority to one or another option
- Differences in the legal framework are not the reason for market fragmentation. The main reasons is linkage to the sovereign spread. In terms of product perception, the investors have perceived even younger CB legislations as sound as the old-established covered bonds, to the extent they allow double recourse and proper segregation of assets. The products are seen as similar in terms of legal risk. The main difference are linked to the "State support" whether implicit or explicit.
- The areas for an intervention in light of more harmonisation are important, but very well identified: definition of common characteristics of the assets (eligibility criteria), transparency and minimum degree of public supervision….. No need for a single Eu global CB regulation aimed at fitting all jurisdictions.
- The reform could be the chance for a complete review of certain aspects which are not clear in the CRR framework (eg. Covered bond definition) or which may drive to unwanted fragmentation consequences and uncertainties.

Specific Country Issues

- In addition to the above, the new Framework should recognise value to the provisions of special legislation that are aimed at strengthening the protection for investors.

PART I: COVERED BOND MARKETS: ECONOMIC ANALYSIS

QUESTIONS - COVERED BOND MARKETS: ECONOMIC ANALYSIS

1. In your opinion, did pricing conditions in European covered bond markets converge and diverge before and after 2007, respectively? If so, what where the key drivers of this convergence/divergence? Please, provide evidence to support your view.

- It is important to stress that the main factors are linked to market movements and linkage to the issuer and sovereign debt.
- As an example it is market practice to compare issuances with government debt having same tenor.

2. Was pricing divergence an evidence of fragmentation between covered bonds from different Member States? Do you agree with the reasons for market fragmentation described in section 2.1 of Part I? Were there any other reasons?

- We believe the primary reasons can be the sovereign risk.

4. Is there an appropriate alignment in the regulatory treatment between covered bonds and other collateralised instruments? If there is a misalignment, could you illustrate what differences in regulatory treatment you deem as inappropriate and why?

Yes. Covered bonds enjoy "preferential" treatment because of a number of characteristics that are unique to this asset class.
The EBA reiterates the appropriateness of the risk weight treatment of covered bonds based on historical performance, the structure of the product and that view is supported.

5. Are operational costs for covered bond issuance lower than for other collateralised instruments? Can you quantify the respective costs, even if only approximately?

- In general terms it is difficult to make a punctual comparison for costs for one-off transactions with costs for issuance programmes, which encompass structural and ongoing costs for both transfer of loans and issuances and higher operative costs for controlling and monitoring activities
- CB programmes, once they are set up, are certainly more efficient than ABS issuances

6. Are there significant legal or practical obstacles to:

a) cross-border investment in covered bond markets within the Union and in third countries?; and

b) issuance of covered bonds on the back of multi-jurisdictional cover pools?

- There are not legal obstacles that impair or limit the possibility for cross border investments or issuance of covered bonds on the back of multi-jurisdictional cover pools.
- A multiplicity of factors however could prevent issuers from using multi-jurisdictional assets (either deriving from legal peculiarities in each jurisdiction, for instance in terms of asset segregation, constitution of guarantees or from fiscal potential issues related to the assets or from operation issues, such as different IT systems).

PART II: EXPLORING THE CASE FOR A MORE INTEGRATED FRAMEWORK

QUESTIONS – LEGAL FRAMEWORK AND INTEGRATION

1. Would a more integrated "EU covered bond framework" based on sound principles and best market practices be able to deliver the benefits suggested in section 2 of Part II? Are there any advantages or disadvantages to this initiative other than those described in section 2 of Part II?

- A more integrated "EU covered bond framework" structured in a balanced way could be beneficial for both issuers and investors. It is important to identify the specific areas in which

any such harmonization can take place, also considering the difference existing in term of structures and models. Indeed, a certain number of areas (such as those indicated by the EBA) can be the object of a new harmonisation effort of the Commission and they would promote market integration without hurting the best practices adopted across the various jurisdictions.

- Such a framework could be beneficial where it allows the continuation of each existing best practice across jurisdictions.

2. In your view, are market-led initiatives such as the "Covered Bond Label" sufficient to better integrate covered bond markets? Should they be complemented with legislative measures at Union or Member State level?

- The creation of the “Covered Bond Label” has been an useful tool in order to extend the integration of covered bond markets across Europe in terms of transparency.
- In this regard, complementing the market-led initiatives with legislative measures also aimed at transposing the results of such initiatives and increasing the level of transparency and disclosure would help in the creation of an integrated market.

3. Should the Commission pursue a policy of further legal/regulatory convergence in relation to covered bonds as a means to enhance standards and promote market integration? If so, which of the options suggested in section 3 of Part II should the Commission follow to that end and why?

- The best solution could be the combination of Option 1 and (in part) Option 2 in a two-step approach.
- In a first moment, the Commission could act through non-legislative coordination measures (Option 1). This would be a soft tool which would encourage the Member States to adopt legislative measures in line with the guidelines indicated by the European Authority and, in addition, would allow the issuer to adapt their programme contractually and well in advance to the enacting of a specific legislation.
- In a second moment, Option 2 could be pursued. In this respect, we think that the best instrument would be a directive, which could ensure – as indicated in the consultation document – a flexible approach by combining detailed requirements in some areas (such as the areas identified by EBA) with high level principles in others (such as the aspects covered by the national legislation).
- We do not believe that a legal instruments repealing national laws (such a regulation) or acting in parallel to such legislation (such as 29th regime) would work in the case at hand, since all the programme are based on existing laws and also the investors are now comfortable with the current legislation regulating such issuances.

4. Specifically, if the Commission were to issue a recommendation to Member States as suggested in section 3 of Part II would you consider that sufficient or should it be complemented by other measures (both legislative and non-legislative)? (see question 8 below)

- As indicated above a combination of recommendation and other non-legislative measures would be a good solution in the short term, since it could have a positive effect avoiding unwanted disruptive consequences.
- In the long term, the indications contained in the non-legislative instrument could be included in a directive in order to ensure full convergence on certain key aspects.

5. On the suggested list of high level elements for an EU covered bond framework:

a) is the list sufficiently comprehensive or should it include any other items?

b) should the Commission seek to develop all the elements or a subset of them?

c) if only a subset, should the Commission give priority to the target areas identified by the EBA Report: (i) special public supervision of cover pools and issuers; (ii) characteristics of the cover pool; and (iii) transparency?

- With regard to the suggested list of high level elements for an EU covered bond framework: a) the list is wide and include also area where the convergence is not crucial, while it does not include an indication of the requirements to be fulfilled by the institutions allowed to issue covered bonds. In particular, the list could include, as set forth in the Italian framework, the level of capital requirements that an issuer should satisfy in order to issue covered bonds; on the contrary we do not think that the issuance of covered bonds should require any license or authorisation additional to the general banking authorisation.
  b) the commission should focus on a subset mainly focused on covered bond definition and protection of term (sub-section I), special public supervision (sub-section II), the cover pool (sub-section IV) and transparency requirements (sub-section V).
  c) yes. The Commission should give priority to the areas identified by EBA which are the ones that could improve the strength of the Covered bond instrument across EU.

6. What are your views on the merits described under section 3 of Part II of using different legal instruments to develop an EU covered bond framework? In particular, would it be desirable to harmonise through a directive some of the legal features of covered bonds and requirements applicable to them under Member States' laws? If it were proposed, how could a 29th Regime on covered bonds be designed to provide an attractive alternative to existing national laws?

- As indicated above, a combination of non-legislative instrument and, in the longer term if necessary, of a directive could be a solution that would ensure harmonization without unwanted disruptive consequences on the market. The legal features on which the harmonisation could be helpful are: a) the level of capital requirements that an issuer should satisfy in order to issue covered bonds; b) covered bond definition and protection of term, c) special public supervision, d) the cover pool; e) transparency requirements (sub-section V). We do not believe that a 29th regime would work in the case at hand, while it could create confusion and legal uncertainty on the investors, which are now well used to invest in covered

bonds based on national legislation.
The aim of a EU reform should consist in identifying and regulating the most important common features of the instrument (and, consequently, regulatory treatments), without the need to change the legal frameworks under which the covered bonds are issued.

7. How should an EU covered bond framework deal with legacy transactions?

- The implementation of a grandfathering regime for a certain period would allow the EU covered bond framework with legacy transactions.
- Any grandfathering scheme should allow eligibility of existing cover pools and maintain the regulatory treatment for all the bonds issued up to a cut-off date for the life of the instruments.

8. Would you view a combination of recommendations to Member States (Option 1) and targeted harmonisation of certain minimum standards (Option 2) as desirable and sufficiently flexible? If so, what should be the subject of each option?

- Please see above (e.g. questions 3 and 5). The combination of Option 1 and Option 2 (directive on certain key elements only) would be desirable and permit to retain a certain flexibility.

PART III: ELEMENTS FOR AN INTEGRATED COVERED BOND FRAMEWORK

QUESTION – COVERED BOND DEFINITION

What are your views on the proposals set out in section 1 of Part III for a "new legal definition" of covered bonds to replace Article 52(4) of the UCITS Directive?

- The proposed "new legal definition" of covered bond, to replace Article 52(4) of the UCITS Directive, would help in giving more certainty to the covered bond framework. In addition, this measure would be helpful in connection with the creation of Art. 129 of the CRR compliance label.
- It should be carefully considered the interaction of the new definition with the various provisions regulating the regulatory treatment. Indeed, a certain degree of difference between two frameworks (such as the difference existing between the Article 52(4) basic requirements and Article 129 more stringent requirements) might be useful. In particular, a two step approach could be followed:
  (a) a general definition of covered bond (replacing and clarifying the definition included in Article 52(4)), which could clarify the minimum features and characteristics to be complied with for an instrument to qualify as covered bonds (e.g. dual recourse, special supervision, segregation of assets);
  (b) requirements for the covered bonds (conceptually in line with Article 129) to get the benefit of preferential regulatory treatment (e.g. quality of assets, transparency, ecc).
  The proposal above would follow the current dual track mechanism with a more general definition proposed under Article 52(4) and the definition provided under Article 129, but – if the new definitions and requirements will be adequately clear, it will help in ensuring more comprehension of the instrument in the market.
- The proposal for a system of certification of qualifying instruments could be of interest to the

extent that (a) it refers to all the instruments issued under the new legal framework (while grandfathering all pre-existing issuances) and (b) if referred to each programme any competent body would be allowed to make a pre-issuance review and a confirmation that the covered bonds would be meeting the relevant criteria.

QUESTIONS – ISSUER MODELS AND LICENSING REQUIREMENTS. ROLES OF SPVs

1. Should the current licensing system be simplified to require a "one-off" authorisation only for all covered bond issuers based on common high level standards? What specific prudential requirements (that is, in addition to those in CRR and CRD) could be applied as a condition for granting a covered bond issuer license?

- The set-up of a programme and the issuance of covered bonds thereunder should not be subject to any specific authorisation. Except for specific prudential requirements, all banking institution duly authorised to carry out banking activity in a jurisdiction should be allowed to issue covered bonds.
- If a bank satisfies the prudential requirements set forth under the CRR/CRD rules (and complies with the MREL limit), it should be allowed to issue covered bonds without the need for any additional capital requirement conditions.

2. If the covered bond issuer is subject to a one-off covered bond-specific licence, what would be the additional benefits of requiring that each covered bond programme be subject to prior authorisation as well? Alternatively, would pre or post notification to the competent authority of the programme and of each issue within or amendment to the programme suffice? How should "covered bond programme" be defined for these purposes?

- We do not think that an authorisation process would add value to the instrument.
- All the issuers are already heavily regulated entities. They are supervised either by the SSM or by national central banks. The issuance of covered bonds is an ordinary funding tool and, as such, should be within the full control of the prudent management of the bank.
- In this respect, a prior and/or post notification to the supervisory authority – in order to keep the supervisor update with the funding plan of the bank would be advisable.
- For the purpose of the above, a programme could be defined as a programme of issuance having common main terms and conditions and backed by a single pool of assets.

3. Should the Framework explicitly allow the use of SPVs to ring-fence cover pools of assets backing issues of covered bonds? What specific requirements should apply to these SPVs?

- Yes, the use of SPVs to ring-fence the cover pool is explicitly regulated under certain legislative frameworks (including Italian framework) and this has generated positive effects with specific reference to:the true and complete segregation of assets (the sale of the cover pool to the SPV assures the real separation with the asset of the issuing bank), the effective segregation of the cover pool in case of insolvency of the issuing bank.
- In this respect, if the SPVs are part of the issuer Group there would be no need for an additional supervision. To the contrary, should they be outside the group, they should be directly supervised, by considering them as financial intermediaries.

4. Regarding the use of pooled covered bonds structures and SPVs:

a) would it be desirable for an EU covered Bond Framework to allow the use of these structures and why? What legal structures are used in your jurisdiction to pool assets from different lenders or issuers?

b) which approach would be the most suitable for pooling assets across borders?

c) where the issuer of pooled covered bonds is an SPV, should this issuer be regulated as a credit institution or as some other form of legal entity?

- Yes, the use of pooled covered bonds structures could be positive for the EU covered bond framework in order to allow also pool of small banks to accede the Covered Bonds market. In addition to the mere recognition, the Framework should positively encourage the pool structures by removing regulatory obstacles to the implementation of such structures.
- The most suitable approach for pooling assets could be through an SPV which would purchase such assets from the different originators.
- The issuer of pooled covered bonds should be a bank or an SPV which would benefit of a guarantee on the bonds issued by it.

QUESTIONS – ON-GOING SUPERVISION AND MONITORING OF COVER POOLS (PRE-INSOLVENCY)

1. In your view, would it be desirable for an EU covered bond Framework to set common duties and powers on competent authorities for the supervision of covered bond programmes and issuers? What specific duties and powers should be included in the Framework and/or EBA or ESMA Guidelines?

- Yes, setting common duties and powers on competent authorities that are specifically tailored on covered bond would result in a positive effect on covered bonds quality in protecting investors and enhancing transparency.
- We do not see the need for an authorisation nor notification process by the public supervisor for amendments to covered bond programmes, as such material amendments are already disclosedto the market by supplementing the prospectuses or publishing notices on the relevant stock exchange where securities are listed.

2. What are your views on the proposals set out in subsection 2.2 of Part III on the appointment of and legal regime for cover pool monitors?

- The cover pool monitor should be appointed by the Issuer, but should meet independency requirements
- The cover pool monitor should be an auditing firm or other qualified professional company
- The cover pool monitor should perform pool audit and verify compliance with coverage tests and to the art 129 CRR. The review should be made on the basis of appropriate “agreed upon

procedures".

- There is no need for a passporting mechanism if the cover pool monitors are selected among auditing companies.

QUESTION – COVERED BONDS AND THE SSM

Should the ECB have specific supervisory powers, and if so which ones, in relation to covered bond issuance of credit institutions falling within the scope of the SSM?

- As mentioned above, the issuance of Covered Bonds should not be authorised in advance.
- Since the covered bonds will continue to be issued on the basis of national level regulation, national authorities would continue to have a specific role in the supervision of these programmes.
- However, for entities which are subject to SSM, prior/post notification should be addressed also to the SSM and a specific reporting should be also put in place in order to ensure full visibility on the performance of portfolios and of the assets segregated in favour of bondholders. In such respect, the transparency template provided for by the Covered Bond Label should be an important tool.

QUESTION – DUAL RECOURSE PRINCIPLE

Do you agree with the proposed formulation for "dual recourse"?

- Yes, subject to what indicated below:
- The definition include a concept of "absolute priority". However, the Framework should allow that the CB payments are subordinated to the so called 'senior expenses' (e.g. transaction providers costs and interest rate swaps entered into in relation to the cover pool)
- The definition defines "full recourse" as the entitlement to the proceeds of the liquidation as "unsecured creditor" for any deficit that may result from applying the proceeds of the cover pool. The requirement should be also satisfied in case the bondholders (or the SPV on their behalf) have the right to proceeds as "unsecured creditor" for an amount equal to the nominal amount of the bonds (and subject to the obligation to pay back to the bankruptcy estate any amount in excess collected in connection with the liquidation of the portfolio).

QUESTIONS – SEGREGATION OF THE COVER ASSETS

1. Are there any advantages to using an SPV as an additional segregation mechanism at issuance? Are cover assets typically transferred to the SPV at issuance via legal or equitable assignment?

- The use of an SPV in the context of an issue of covered bonds permits to obtain the full segregation of assets, considered that the SPV is an external legal entity, and to identify precisely the assigned assets. See Part III par. 2 question 3
- In the Italian framework, the cover assets are typically transferred to the SPV via legal

assignment.

- Such legal structure of a transfer through SPV has been on the one hand fully appreciated by the market and investors for over fifteen years, on the other hand carefully assessed by rating agencies, both on ABS transactions and on covered bonds as they rely on the same law.
- In conclusion the use of SPV, within the covered bond framework, has proven to be a successful mean of asset segregation, as well as other types of asset segregation used in other jurisdictions.
- Furthermore, the SPV use would favour pooling of assets from different originators

2. In your jurisdiction, what legal and practical steps are required in order to segregate effectively the cover assets from the issuer's insolvent estate or in resolution? Would it be necessary to serve a notification to each borrower of the issuer? Until notification is served, what is the legal status of any proceeds of the cover assets which may be paid directly into the insolvent estate or to the issuer in resolution?

- Generally speaking, in order to fully segregate the assets from the Issuer's capital, under the Italian framework, the Issuer is required to register the sale of receivables identified by means of common criteria with Companies' Register and to publish a notice of the assignment in the Official Gazette.
- The registration of the sale of the receivables in the Companies' Register and the publication of the notice of the assignment in the Official Gazette are necessary in order to render the assignment enforceable against the debtor. Even if this is not necessary to make the assignment effective against the debtor, seller is also obliged to give notice to the debtor of the assignment as soon as possible.

QUESTIONS – LEGAL FORM AND SUPERVISION OF THE COVER POOL

1. Should the cover pool be incorporated as a regulated entity? In that case, what type?

- In the Italian legal framework the cover pool is assigned by way of true sale to an SPV, which is a separate legal entity. Therefore in such a framework there is no need for the cover pool itself to be incorporated as a separate legal entity. Should the SPV be part of the Issuer group, the supervisory authority would have the power to supervise also the SPV

2. Who should be the supervisory authority for these purposes, the competent authority or the resolution authority?

- Please see above.

QUESTIONS – SPECIAL ADMINISTRATOR OF THE COVER POOL

1. What are your views on the proposals set out in subsection 3.3 of Part III on the

appointment and legal regime for a cover pool special administrator?

- This proposal is less relevant for cover pool which are segregated through SPVs. Indeed, if the assets are owned by an SPV, the management of the cover pool can be contractually regulated. The regime of the special administrator could be useful only to the extent that it would be obliged to act in accordance with the contractual provisions regulating the liquidation of the cover pool

2. Should the special administrator be obliged to report regularly to the relevant supervisory authority? Should the content and regulatory of such reporting be the same as for the issuer?

- The special administrator ought to report to the relevant supervisory authority.

- The national supervisory authority has to be part of post-default proceedings.

QUESTIONS – RANKING OF COVER POOL LIABILITIES

1. Do you agree with the suggested ranking for cover pool liabilities? Is the wording proposed in subsection 3.3 of Part III sufficient to define clearly the claims that may arise, avoid confusion between claims and prevent claims in an unreasonable amount from arising?

- Services providers and interest rated hedging counterparties should be allowed to rank senior to the covered bondholders, since their activity is relevant for the protection of the value and the management of the cover pool. The possibility for certain liabilities to rank senior to the CB should be taken into account in asset coverage test calculations.

2. Is it possible to define hedging activity better and, if so, how?

- The hedging activity could be described as the activity carried out in the context of asset swap agreements and liability swap agreements entered into for the purpose of hedging interest rate (and currency) risks under respectively the cover pool and the covered bonds.

QUESTIONS – INTERACTION BETWEEN COVER POOL AND ISSUER IN INSOLVENCY/RESOLUTION

1. Are current provisions in EU law sufficient to deliver effective protection for bondholders in a resolution scenario involving covered bonds? In particular, is it sufficiently clear:

a) how the cover pool would be segregated under each possible resolution or recovery scenario of the issuer?

b) how the full recourse against the issuer would take effect if the issuer is in resolution and is not placed subsequently into liquidation?

c) what procedural steps should be followed in resolution and by whom in order to make

effective the dual recourse mechanism?

- On the one hand, the current EU law does not provide for any effective protection for cover pool and covered bondholders. Only art. 52 IV UCITS requests a kind of segregation, but leaves unregulated what level of segregation should be achieved and in what way. The BRRD referrers expressively to covered bonds, but does not treat in a comprehensive manner the point of the segregation (limited protection is given under Article 79, with reference to segregation aspects). Given the segregation of the cover pool in the SPV, as provided in the domestic legislation, it has to be considered that the resolution tools and powers under the BRRD are not applicable in respect of the cover pool.
- Under Italian law, covered bondholders benefit from two different claims: one against the cover pool segregated in the SPV, and the other against the issuer. We understand that the full recourse against the issuer might be impaired to the extent that the liabilities would exceed the foreclosed value of the cover assets, as on the exceeding amount the BRRD resolution tools may be applied. The Framework should ensure that – until the covered bonds are repaid in full – the bondholders should have a recourse to the general assets of the issuer for any amount not repaid through the liquidation of the cover pool. In this respect, the Italian legislation may provide a guidance (at least for covered bonds carried out segregating the cover pool in a vehicle). Indeed, according to the Italian framework, in case of liquidation of the issuing bank, the guarantor makes the payment under the covered bonds on the basis of the original timeline and exercise on an exclusive basis the rights of the noteholders vis-à-vis the issuing bank. As a consequence, the guarantor would have the right to apply for the amount already paid by it under the guarantee and for the amount not yet paid (but that it will be paid) under the guarantee in the future. In case the sum of (a) the proceeds of the cover pool and (b) the amounts paid by the issuing bank to the guarantor, exceed the amount due under the covered bonds, any excess would be paid back to the issuing bank. The same mechanism applies in case of temporary suspension of the payment obligation of the issuing bank.
- In order to have effective the full recourse mechanism, the resolution plan of each institution should deal with the existence of covered bonds programme.

QUESTIONS – RESIDENTIAL AND COMMERCIAL LOANS

1. Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets? Should certain riskier residential or commercial loans (ie buy-to-let mortgages; second home loans; loans to real estate developers; etc.) be excluded from the cover pool or permitted subject to stricter criteria?

- The definition should be more objective and should not be subject to subjective or discretionary elements (such as the purpose of the loan or other particular features, which is not perfectly in line with Italian regulation). The risk of such proposed definition is not to be aligned with specific national regulations on mortgage loans.
- This could be ensured making reference to the category of the assets. Residential mortgages should be mortgages secured by residential properties and commercial mortgages by commercial properties. Also reference to cadastral registers could be used in order to ensure

correct classification.
- We do not think that any particular assets should be completely excluded, but that the issuer should give appropriate disclosure to the investors of the inclusion of any such assets in the cover pool.

2. In relation to mortgage loans:

a) what are your views on the proposed requirements on "perfection of security" and "first ranking mortgage"? Is registration of the security a requirement for perfection in your jurisdiction?

b) is the enforceability of mortgages in the different Member States equivalent or should there be additional requirements to ensure their equivalence?

c) are minimum standards for mortgage rights in third countries necessary?

- a) We agree on the proposed requirement on the mentioned definitions. In the Italian framework the Bank of Italy prudential regulation requires that eligible mortgage loans must provide for a mortgage being duly registered; with reference to "first ranking", the Framework should allow (i) "economic first ranking" to be included in the cover pool. In particular, to the extent that any prior ranking secures an extinguished mortgage or a mortgage securing a limited amount, this should be taken into consideration for the purpose of LTV eligibility requirements, but it should not affect per se the possibility to have such loans in the cover pool; and (ii) any subsequent ranking.
- In addition, regulation should ensure that also third parties mortgageors are not excluded from such definition. The definition of mortgage loan should read: (…) for the benefit of the lender by a security or lien on a property", not on "the property".
- b) In our opinion there is no specific need for providing additional requirements to ensure equivalence for the enforceability of mortgages, provided that this refers to a general concept of national laws within EU;
- c) Yes, minimum standards for mortgage rights in third countries shall be at least equivalent to EU standards.

3. In relation to LTVs:

a) what are your views on the proposals set out in subsection 4.1 of Part III on minimum LTVs?

b) in the case of insured properties, should higher LTV limits be allowed if the insurance cover meets certain requirements and, if so, what should such requirements be? In what other cases should higher LTV limits be allowed?

Could loan-to-income requirements be used to replace or complement LTV limits?

c) should there be an additional average LTV eligibility limit at portfolio level?

d) with the advent of a Binding Technical Standard defining Mortgage Lending Value, is it appropriate to apply this for eligibility in all cover pools across the Union as a prudent measurement?

e) should LTV limits be used to determine: eligibility (loan in/out) of loans at inception? Eligibility (loan in/out) of loans on an ongoing basis? Should they instead be used to simply determine contribution to coverage? A combination of the above?

a) In general terms, we agree that the Framework should regulate LTV limits in order to avoid huge discrepancies between countries. With specific reference to the features which the Framework would seek to apply, we note the following:
- we agree on the distinction between residential and commercial loans to set different LTV limits.
LTV limits could be used for the calculation of collateralisation level. In case an LTV limit is also set as eligibility criterium (we do not particularly share this solution, however we could live with it), this should be limited to the date of transfer; subsequent changes to the LTV limits should not affect inclusion in the cover pool, but they should affect the calculations of collateralisation. (i.e. the portion of the loan contributing to the general collateralisation). Otherwise such criterium would be disruptive.
We do agree that LTV should be evaluated on specific properties and updated in accordance with ordinary prudential requirements under the CRR.
It is not clear what the paper means for "recognition of privilege for any excess over LTV cap". If this is referred to LTV at cover pool level, it is clear that all the proceeds (including the proceeds in excess of LTV level) would be used to repay covered bondholders in priority to other creditors (up to the covered bond nominal amount); to the contrary, if this is referred to individual LTV limits, the privilege could not be considered, since any excess on the loan secured would be paid back to the mortgagor/debtor.

- b) Higher LTV should be allowed in respect of insured properties, in respect of which an umbrella policy for the risk of default could be considered;
  no reliable and updated debt –to-income data are available. Some proxies may be used but would introduce a misalignment between countries.
  In case of hard limits on LTV, an insurance could lead to allowing also higher LTV.
- c) We do not think that an additional average LTV eligibility limit should apply;
- d) The implementation of these standards could generate relevant issues both in the step-in phase and in the managing of the pool of assets' already assigned. Indeed, the Mortgage Lending Value is more complex that the LTV concept, since it is designed to be robust against market fluctuations and, therefore, this could be penalising; this should apply only in respect of loans that – in accordance with general banking regulations – must be originated using the MLV
- e) the LTV limits should be used to determine contribution to coverage. LTV limits should apply as eligibility criteria (loan in-loan out) at inception. As we pointed out previously, we do not support such loan in - loan out criterium. In addition, the application of LTV limits as eligibility criteria (loan in-loan out) on an ongoing basis could be really disruptive. On an ongoing basis, the only reasonable solution is to adapt calculation on contributions to ongoing LTVs.

  In addition we see an issue in obliging issuers to replace NPL assets. In our experience NPL should remain in the cover pools provided that the general coverage requirements are met.

In other terms in the Italian frameworkthe ponderation of NPL is currently zero in the performance of the periodic asset coverage or similar tests on the programmes. In such a way keeping the NPL inside or excluding them from the cover pool is neutral in terms of test at a givendate.

Another reason for keeping NPL inside the cover pools would be a factor of continuity on historical statistics.

4. In relation to the valuation of cover assets:

a) how frequently should the value be updated and in which way (revaluation, update of the initial valuation, and in which way)?

b) what criteria should be applied to (i) the valuer and (ii) the valuation process to ensure that they meet the transparency and independence principles set out in the first and second subparagraphs of Article 229(1) CRR?

- a) The value of covered assets should be updated on an annual basis, by means of updating the initial evaluation.

6. In light of the EBA's prudential concerns in relation to the use of RMBSs and/or CMBSs in cover pools, should the Framework exclude these assets completely from qualifying as cover assets (including, for these purposes, as substitution assets) or should they be allowed only subject to strict criteria and within the 10% limit currently permitted under Article 129 of the CRR? What is the added value and practical uses of RMBS/CMBS as collateral in your jurisdiction/issuer?

- ABS inclusion in cover pool should be allowed only if compliant with terms established in 129 of CRR.
- The practical use is that RMBS/CMBS could be used within a CB programme with poling structures where assets are originated by different entities. In such a scheme each originator would retain the equity tranche of the securitisation, whereas the senior tranche would be part of the covered bond cover pool. In such a way the originator would retain the first loss of the securitisation and would be entitled to receive the excess spread of the portfolio after payments on the senior note.
- Another use of such structure may be used by different banks of a same banking group, where one bank (supposedly the parent company) is the issuer of the covered bonds and other banks are originating their own portfolios, which will be securitised and the senior notes would be part of the cover pool of the covered bond programme. The same goals outlined above would be achieved.

QUESTIONS – PUBLIC SECTOR LOANS

1. What are your views on the proposals for public sector loans as cover assets set out in

subsection 4.1 of Part III?

We agree that public sector loans should remain as covered assets as in the current national framework.
As we understand, the proposal for public sector as regard loans to or exposures granted by regional governments or local authorities or public sector entities of Member State is limited to cases in which exposures to such public entities have the same treatment as central government (or central bank) of Member States (which means a risk weight of 0%). We highlight that Italian legislation on covered bonds include also regional government, local authorities and public sector entities having a risk weight of not more than 20%. We believe that the proposal should be amended and include also loans to and exposures granted by regional governments or local authorities or public sector entities of Member State treated as provided by Article 115, par 5, of the CRR, and Article 116 par. 1, limited to public sector entities having a risk weight of 20%.

2. What eligibility requirements in terms of validity and enforceability should apply to the guarantee granted by the relevant public sector entity?

- Italian legislation on covered bonds as regards the guarantee granted by the relevant public sector entity, provides for by eligibility requirements as regulated by the former European legislation on credit risk mitigation (at the time 2006 CRD as subsequently amended for unfunded credit protection). We believe that now reference should be made to CRR' s eligibility requirements on unfunded credit protection (Articles 203, 213 and 215 of CRR).

QUESTIONS – OTHER ASSET CLASSES: AIRCRAFT, SHIP AND SME LOANS

1. Should the Framework exclude aircraft, ship and SME loans from cover pools or should they be allowed only subject to strict criteria and limits? If so, what criteria and limits should be applied?

- SME loans should be eligible for dual recourse instruments recognised by European frameworks. In fact, SME loans are an important component of the CMU proposal, therefore we do not see why they should be excluded from any regulation on dual recourse instruments, giving right to be ECB eligible, UCITS compliant, non-bail in-able and entitled to receive a preferential regulatory treatment.
- For collateral types currently not benefiting from regulatory privileges, namely SME loans, ship loans and aircraft loans, we are willing to develop a new kind of dual recourse instruments, the European Secured Notes (ESN) as illustrated in the green paper provided by the ECBC for the EC consultation on CMU.
- We believe that the variety of SME loans originated across Europe require the envisagement of a new kind of double recourse instrument, tailored for them.

2. In relation to SME loans, is it possible to identify a category of "prime" SME loans as a potential eligible asset class for cover pools?

- In particular SME portfolios should be granular in order to avoid high concentration risk.

QUESTIONS – MIXED POOLS AND LIMITS ON EXPOSURES

1. Do you agree that mixed-asset cover pools should be allowed?

- Yes. They should be allowed

2. What are your views on the proposed limits on specific assets and concentration of exposures? Should any other limits or requirements apply?

- We agree that assets representing exposures to credit institutions should be limited.
- We do agree with limitation on exposures to third countries public sectors loans
- We do agree on concentration limits on the single obligor's name.
- We do not agree that a concentration limit on the exposures to credit institutions should be included. Although, in ordinary Covered Bond programmes a concentration limit would create complications in the management and investment of the liquidity and this may drive to unwanted operational risks to be increased for the covered bondholders.

QUESTIONS – COVERAGE REQUIREMENT

1. Which option should be preferred for the Framework to formulate the coverage requirement and why?

a) a general requirement along the lines of Article 52(4) of the UCITS Directive, amended to include the wording suggested by the EBA;

b) a nominal coverage;

c) a net-present value coverage;

d) a net-present value coverage under stress; or

e) any other or a combination of the some or all of the above.

- The preferred option would be for a), or b) above. Option c) could also be practicable in principle, but homogeneous criteriashould be used to apply stresses.

2. If the coverage requirement were formulated as net-present value coverage under stress, should the stress tests be specified in any form in the Framework or ESMA/EBA regulatory guidelines? If so, what specific stress tests should be required and why?

- Introducing specific stresses applicable to any CB programme may pave the way to possible distortions. In general terms stresses may depend on the specific mortgage market (for instance stresses are on pre-payments, defaults and similar factors, which cannot be the same for every country, every market and for any point in time).

3. Should derivatives entered into in relation to the cover pool be taken into account for the purpose of determining the coverage requirement? If so, what valuation metric should be used for these purposes?

- Yes. Under the Italian legal framework an "Interest Coverage Test" is performed: portfolio interests should cover payments of CB interest and costs of programme including hedging

4. What exposures to credit institutions within the pool should be taken into account to determine the coverage requirement and why?

- We understand that the aim would be to avoid a concentration of exposures to credit institutions which would replace in the cover pool more core assets such as mortgages (or public sector assets). In the Italian regulation a limit of 15% already exists in terms of substitute assets to be allowed in CB programmes, which include also exposures to credit institutions.

QUESTIONS – OVERCOLLATERALISATION

1. Should a quantitative mandatory minimum OC level be set in the Framework? If so, what should that level be and should it be the same for all types of covered bonds?

- In our view the Overcollateralization depends on a number of factors, eg characteristics of the assets, mismatch between assets and liabilities, therefore each OC level is set according to specificities of the relevant CB programme.
- It is of common knowledge that mandatory OC levels are set by rating agencies in order to achieve a certain rating on the covered bonds.
- However, as there are huge discrepancies in the different jurisdictions (and on the rating level achievable), setting a minimum level for every Eu CB programme (e.g. not exceeding 2%) may be acceptable. Higher levels may lead to distortions as may be penalising for certain issuers/CB structures.

2. If a mandatory minimum OC level were set in the Framework, should there be exceptions to the requirement? (for example where the issuer applies a precise "match funding model" or where certain targeted liquidity and market risk mitigation measures are used - see subsection 4.3 of Part III)

- As stated above, we do not recommend a universal level for every programme. Consequently if there were such common minimum level (eg 2%, as defined in the EMIR) there should be no exceptions.

3. Should the Framework set a maximum level of permitted OC? If so, when and at what level?

- Again, a maximum level may not be set as it depends on the characteristics of the programme. Rating agencies are entitled to request higher levels of OC according to the required rating level.

4. Should the Framework provide for the treatment of voluntary OC in the event of insolvency/resolution of the issuer?

- All the assets segregated for the benefit of bondholders should be used in priority to repay the exposures under the covered bonds. The Framework should only ensure that, once that the covered bonds are repaid, the assets (or the proceeds arising out of their liquidation) are returned back to the issuer.

QUESTIONS – MARKET AND LIQUIDITY RISKS

1. In your view, are OC levels adequate to mitigate market and liquidity risks in the absence of targeted measures such as those described in subsection 4.3 of Part III?

- Yes. Current OC levels derive from analysis performed by issuers and rating agencies. In particular the latter include in their analysis stress scenarios on the portfolio, interest rates and underlying assets.

2. Should the Framework lay down specific requirements on the use of derivatives as suggested in subsection 4,3 of Part III? How should "eligible counterparties" be defined for the purposes of entering into permitted derivatives?

- We do not fully agree with the proposal. First of all, hedging should not be an obligation but an option, there are a number of ways to address interest rate risk (OC for instance). We see a number of CB programmes with no hedging.
- In addition it would be extremely difficult to foresee the characteristics of the hedging counterparties although they match minimum rating requirement
- We do not see why hedging intra-group would be forbidden.
- We agree on paripassu with claims of covered bondholders in post issuer default scenario

3. What are your views on the potential provisions on the management of cashflow mismatches suggested in subsection 4.3 of Part III? In particular:

a) for issuers, do cashflow mismatches between cover assets and covered bonds arise in your jurisdiction and/or transactions, and, if so, in which way? Are you able to describe a scenario for the timely repayment of the covered bonds? Do you plan for contingencies? Are such scenarios and contingencies disclosed to investors?

b) for investors, do you understand how such cashflow mismatches would be dealt with in practice? Would it be beneficial from your perspective to get systematic information about cashflow mismatches and how these would be managed?

- Cash flow mismatches are addressed internally by ALM practice and the rating agencies make their own assumptions, this requesting certain OC levels.

- In post issuer default scenarios there could also be specific contractual provisions to address such issue through specific test and ultimately through CB maturity extension.

4. On the EBA's liquidity buffer recommendation:

a) should covered bond issuers hold a "liquidity buffer" to mitigate liquidity risk in the cover pool and, if so, in what circumstances?

b) should the buffer be calibrated to cover the cumulative net out-flows of the covered bond programme over a certain time frame? What length of time should be used as a time frame for calibration purposes?

c) what eligibility criteria should liquid/substitution assets meet to qualify for the purposes of this buffer?

- Some CB programmes already have certain liquidity buffers in order to cover interest flows and senior expenses over a certain timeframe. Such buffers are requested by rating agencies and tailored on the programme's characteristics.

QUESTIONS – TRANSPARENCY REQUIREMENTS

1. What are your views on the current disclosure requirements set out in Article 129(7) of the CRR? If more detailed requirements were preferred, do you agree that issuers should disclose data on the credit, market and liquidity risk characteristics to a more granular level? If so, what data and to what level of granularity?

- Information requested under art. 129.7 are in our opinion sufficient to address investors' needs.

2. Should issuers disclose information on the counterparties involved in a covered bond programme and, if so, what type of information?

- If you mean disclose information on which counterparties participate to a CB programme (such as trustee, calculation agent, hedging counterparty or other) we do not see any problem.

3. How frequently should covered bond issuers be required to make disclosures to investors?

- as per the Label template: on a quarterly basis. This is the maximum achievable.

4. What are your views on the existing and prospective investor reporting templates prepared by industry bodies and referred to in section 5 of Part III? Would these templates:

a. be granular enough to enable investors to carry out a comprehensive risk analysis as recommended by the EBA? and

b. be sufficient without further legislative backing to deliver enhanced and consistent disclosure in European covered bond markets?

- Yes, we estimate the Label Transparency Template is sufficiently detailed to enable investors to make their own assessment on the performance of the deal. In addition its merit is to be cross-jurisdiction: therefore it make all CB comparable.

6. Should the same level of disclosure standards apply pre- and post-insolvency/resolution of the issuer (except for those reporting items referring to the issuer itself)?

- We agree

7. In relation to covered bonds issued in third countries, what minimum level of disclosure should apply for European credit institutions investing in those instruments to benefit from preferential risk weights?

- Countries outside EU may obtain the Covered Bond Label, thus are obliged to comply with the label template in exactly the same terms as EU issuers.