MINISTRY OF BUSINESS AND GROWTH
DENMARK

ANNEX – DANISH RESPONSE TO THE CONSULTATION

Part II – Exploring the case for a more integrated framework

1. Legal framework and integration

1.1. 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” is likely to deliver some of the benefits suggested in section 2 of Part II as long as it builds on the experiences of well-functioning national systems, such as the Danish mortgage credit system, and is not achieved at their expense.

The Danish government believes that a directive leaving room for the national systems is the best way to achieve the benefits suggested.

This being said, section 2 of Part II on benefits and challenges of an integrated framework does not seem to recognize the challenges that exist as regards adjacent legislation. Covered bonds legislation is in many ways dependent on other parts of national legislation, including but not limited to insolvency regulation, enforceability of mortgages, rules governing the cadastral register and land registration. The adjacent legislation is of very significant importance in securing well-functioning national covered bonds systems. A process towards a more integrated EU covered bond framework would have to recognize this and further analysis on the matter should be made before deciding on the level of harmonisation of the specific covered bonds framework.

Summing up, the Danish government supports a covered bond framework in the form of a directive as long as it is possible to maintain core elements of the Danish mortgage credit system. We, however, find it important that analysis on the adjacent legislation is made before deciding on which elements should be part of a future directive on covered bonds and witch parts should only be made subject to recommendations and soft law. This being said, for a sufficiently effective framework to be made it would be necessary that harmonisation through a directive would cover the major parts of the covered bonds regulation.

1.2. 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?

In our view, market-led initiatives lack the protection which follows from supervision of a regulatory framework. The prudential element entailed in supervision secures the appropriate common standard for covered bonds.

Market-led initiatives should, therefore, as a minimum be complemented with recommendations in the relevant area to ensure a common ground for best practices in the Member states. As already mentioned, however, the Danish government finds that a directive setting the minimum standards could better ensure the integration of the covered bonds market.

1.3. 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?

Covered bonds play an important role to the Danish economy just as other national covered bonds systems do in other economies. Any further harmonisation of covered bonds legislation will, therefore, have to respect well-functioning national systems.

From a Danish perspective, we find that a directive setting the minimum standards would be the best way to ensure the integration of the covered bonds market.

A directive would, however, have to respect core elements of the Danish covered bonds system thereby enabling our system to continue in the future without material changes.

First of all, it is vital for the Danish government that the specialised mortgage credit institutions can maintain the business model funding loans solely through the issuance of bonds and not e.g. through deposits.

Secondly, together with the specialised banking model, at least these following core features of the Danish model should be kept: Match funding with a close match between a loan and the bonds funding the loan, the balancing principle limiting the liquidity- and market risks, the capital centre structure with separate capital requirements to each centre and to the mortgage credit institution in general but without requirements specifying that each capital centre should be a separate legal entity and specialised insolvency regulation.

To the extent that these and other core features of the mortgage credit system in Denmark can be maintained the Danish government would be supportive of further regulatory convergence in relation to covered bonds in the form of a directive leaving room for national flexibility.

1.4. 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)

Further harmonisation based on recommendations can to some extent promote market integration as it may be expected that the recommendations will set the market standard.

To achieve integration of the different national covered bonds regimes while not changing the basic elements of well-functioning national systems, however, the Danish Government believes that a directive would be the best solution.

We find that a directive can best ensure the characteristics of well-functioning national regimes while providing the sought after clarity on the treatment of covered bonds. As mentioned in the consultation paper a directive would make a flexible approach possible. In our view, this is the best way forward.

The Danish Government does not support a regulation, which would be directly applicable in national law. We find that a regulation would not leave a sufficient degree of flexibility for national rules which take into account the characteristics of the national covered bond systems.

Regarding the proposed 29^{th} Regime, a regime providing a fully integrated system for issuers without the need for amendments to existing national covered bonds legislation might at first glance seem appealing. However, if the consultation does result in a general wish for a more integrated covered bonds framework the Danish government finds it more appropriate to create such a framework through either recommendations or legislation.

In our view, recommendations and legislation can ensure that the sought after integration is properly ensured whereas a voluntary system runs the risk of not enough issuers choosing to issue under the regime. In this case, a 29^{th} Regime will be insufficient as it will not ensure the needed integration. As pointed out in the consultation paper, even if a sufficient amount of issuers make use of the system over time the 29^{th} Regime will create increased fragmentation in the short run before sufficient issuance volume is reached.

1.5. 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?

In our view, the list seems sufficiently comprehensive for further work on a legislative framework. As already mentioned, this further work should preferably be in the form of a directive.

This being said, it is important for all of the high level elements listed that further analysis be made. This analysis should focus on which of the elements could be harmonised fully and in detail and which of the elements should be subject to high level principles. Such an approach will leave a sufficient degree of flexibility for national rules which are accustomed to the characteristics of the national covered bond systems.

To find that right balance between harmonisation through a directive and high level principles through recommendations is especially relevant due to the differences that exist between universal banks and specialised mortgage credit institutions. An EU covered bond framework should take into account that the different structures of a universal bank and a specialised mortgage credit institutions demand for the rules for e.g. coverage requirement and overcollateralization to be implemented with due regard to the different business models.

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

In our view, it is useful to concentrate on all elements specifically related to covered bonds. This being said, however, we find that other issues of a more general importance could be handled elsewhere.

Besides this, we find that many of the elements in the directive establishing a framework for the recovery and resolution of credit institutions (BRRD) have a connection to the work that is currently on-going on in the field of covered bonds. This is the case e.g. in the making of the recovery and resolution plans.

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?

We find that it is useful to focus on all elements specifically related to covered bonds. If focus is only on a subset, however, we find that the characteristics of the cover pool are a central element of the regulation of covered bonds and that this specific subject should receive special attention.

1.6 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?

In our view, using different legal instruments to develop the EU covered bonds framework run the risk of being fragmented and unnecessarily complex.

As described above, we find that targeted harmonisation through a directive – possibly in combination with recommendations in the areas where the need for regard to specialised national rules is necessary – has the advantage of ensuring a more integrated covered bonds framework while leaving room for well-functioning national systems.

As for the 29th Regime, as pointed to above, the Danish government is inclined to believe that a voluntary system will not ensure the integration in regard to covered bonds that is sought.

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

The Danish government agrees that careful consideration should be given to grandfathering or transitional provisions, thereby ensuring the interest of the existing investors and the financial stability in the Member States.

1.8 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?

In our view, a combination of recommendations and targeted harmonisation through a directive could be a good solution to ensure a common ground for the future covered bond framework while leaving room for national interpretations. For a sufficiently effective framework to be made, however, it would be necessary that harmonisation through a directive would cover the major parts of the covered bonds regulation.

The recommendations would be useful regarding the parts of the covered bonds legislation where the adjacent legislation in the national regimes makes harmonisation more challenging and extensive and where recommendations on best practice would provide the necessary flexibility.

Part III – Elements for an integrated covered bond framework

1. 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 Danish government believes that having a new legal definition of covered bonds could be a useful element in ensuring the “covered bonds brand” while at the same time ensuring the role of covered bonds as e.g. instruments to place funds or handling liquidity risks.

We support a definition of covered bonds which sets out common standards where only covered bonds meeting the requirements could make use of the term covered bonds.

When deciding on the specific elements of this covered bonds definition, Denmark is in favour of a two tier definition. In this way, we support a covered bonds definition including a broad basic definition of covered bonds plus an additional set of criteria giving the latter some more preferential treatment than covered bonds which only comply with the broad definition. Such a two tier definition is already the case today with a broad basic definition of covered bonds as set out in article 52 (4) of the UCITS Directive plus an additional set of criteria as set out in article 129 of the CRR giving the latter some more preferential treatment than only-UCITS-compliant covered bonds.

The LTV limit requirement in CRR (not present in UCITS) means that specialised institutions are required to fund additional cover assets (typically government bonds or other non-mortgage CRR eligible assets) when property prices are decreasing to the extent that the LTV-limits are exceeded. In certain very stressed scenarios - although such a situation has never materialized in Denmark - it may turn impossible for the Danish mortgage credit institutions to continue to fund additional cover assets and it is in this situation imperative that the issued covered bonds remain

UCITS-compliant as well as the institutions can continue to fund the real economy with only-UCITS-compliant covered bonds.

For Denmark, keeping a two tier definition is therefore very important.

2. Covered bonds issuers and system of public supervision

2.1. *Issuer models and licence requirement. Roles of SPVs*

2.1.1. 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?

A “one-off” authorisation based on common high level standards could simplify the covered bonds programmes. A “one-off” authorisation is the current practice in Denmark and in several other countries.

Where universal banks or specialised mortgage credit institutions meet the requirements of CRR and CRD, especially with regard to the rules relevant for issuing covered bonds, further requirements in regard to the issuance of covered bonds do not seem necessary. We find that CRR and CRD form a detailed and high standard for credit institutions thereby constituting the necessary basis for issuing covered bonds. Following this, we do not find further requirements necessary.

2.1.2. 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?

If a covered bond issuer has been granted the authorisation to issue covered bonds in general, requiring that each covered bond programme be subject to prior authorisation as well would make it more complex and expensive for the issuer without adding much security to the system. Following this, we find that demands for notifications or renewing or extension of the authorisation in case of major changes to the covered bonds programme would suffice.

In case there is only a “one off authorisation” the definition of a covered bond programme would in practice be the whole credit institution.

Following this, in our view the covered bond programme in a system with a one-off authorisation should be defined as the issuer's business model and organisation relating to covered bonds issuance at the time of authorisation to issue covered bonds.

2.1.3. 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?

As a starting point, the Danish government would not be in favour of ring-fencing cover pools through SPV-structures where the SPV does not hold a credit institution license securing at least normal supervisory involvement and requirements to capital, management, governance, etc. The use of SPVs should therefore only be allowed within a future European covered bond framework *if* a level of security and overall regulation directly comparable to the situation with the cover pool on the balance sheet of a credit institution-issuer can be achieved.

The Danish government believes that a basic requirement should be that covered bonds shall be issued by credit institutions and that the assets should be ring-fenced in structures meeting the same requirements. This ensures that rules on capital, management, governance, supervision etc. apply and will be part of the basis for the issuance of covered bonds.

In light of the above, it is the opinion of the Danish government that a specialised mortgage banking structure like the Danish one is an appropriate solution to the issues related to covered bonds issuance. Danish mortgage banks are credit institutions and thus have to fulfil all requirements for credit institutions. In addition, they are restricted further by special national legislation which e.g. prohibits taking deposits thereby effectively eliminating the question of asset encumbrance. In addition, the special legislation on balance principle, valuation etc. requires additional supervisory control resulting in a comprehensive supervisory effort towards these specialised institutions.

In a way, one could say that these specialised banks are SPVs being owned by or otherwise related to universal banks. This is the case since they are confined to a very restricted business related to issuing covered bonds as funding for lending against mortgages. However, importantly, they are credit institutions regulated by all rules pertaining to credit institutions in addition to further special national rules and under strict supervision of the Danish FSA.

2.1.4. 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?*

Joint funding arrangements are allowed according to Danish legislation (based on CRR article 496). The issuer needs a specific authorisation from the Danish FSA for each joint funding arrangement.

In the case of joint funding arrangements for non-group related companies it is a requirement that the loans and the mortgages are transferred to the issuing credit institution. In the case of joint funding arrangements in intra-group cases the issuing credit institution will need a security from the funded credit institution, giving the issuing credit institution direct access to the cover pool (complying with CRR article 129) of the funded credit institution (i.e. covered bonds backed by other covered bonds). Thus, the situation is directly comparable to a situation where there is no joint funding.

Such arrangements should be possible also in a future integrated EU framework. Following this, it is therefore important that these structures can continue even if article 496 in CRR is removed. In this context it should be mentioned that it is essential for us that the derogation in article 496 in CRR is not removed before a new legal basis is in place ensuring the existing intra-group structures may continue without interruption.

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

When pooling assets across borders a uniform level of security should apply. The pooling of assets should be ring-fenced in structures meeting the same requirements as is the case for credit institutions. This ensures that rules on capital, management, governance, supervision etc. apply and will be part of the basis for the pooling of assets across borders as well as nationally.

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?*

See the answer to question 2.1.3.

2.2 On-going supervision and cover pool monitoring (pre-insolvency)

2.2.1 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?

In our view, the supervision of credit institutions more generally should be dealt with in the regulation covering all credit institutions. Following this, the Danish government finds that the duties and powers on competent authorities should as the main rule not be part of the covered bonds framework.

This being said, in case there is specific supervision of covered bonds not relevant for other credit institutions this could be dealt with in the European framework for covered bonds, this could e.g. be in the case of valuation of cover assets.

2.2.2 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 Danish government sees no need for a requirement for independent third party cover pool monitors. On the contrary, we find that the role of the cover pool monitors described in the consultation could be carried out by the competent authorities as is the case in Denmark today.

In our view, the Danish regulation of segregation of assets in cover pools can be controlled effectively by the competent authority. See answer to question 3.2.2.

2.3 Covered bonds and the SSM

2.3.1 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?

Today, for Member States participating in the Banking Union the supervision of covered bond issuance of credit institutions is a national responsibility. Whether the ECB should have specific supervisory powers in this area depends on the character of the future covered bonds framework in EU. Following this, we find that there is a need to explore this issue further before considering whether there is a need to change the rules.

3. Dual recourse principle

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

The EBA report states that best practice on dual recourse is in accordance with article 52 (4) in the UCITS Directive. The proposed formulation for the dual recourse principle in the consultation document grants the bondholders a direct claim against the cover pool on an *absolute priority basis* upon default of the issuer and a full recourse claim against the issuer's estate which ranks *pari passu* with the claim of the issuer's unsecured creditors.

In the Danish mortgage credit model dual recourse grants the bondholders a direct claim against the cover pool on an absolute priority basis upon default of the issuer, and also a direct claim against the issuer's estate if the assets in the cover pool are insufficient to secure payment to the bondholders in full. Following this, the current Danish formulation of the dual recourse principle is different from the formulation proposed by the Commission as the bondholders have an absolute priority in both the cover pool and against the issuer's estate.

The Danish government can support the dual recourse principle as proposed by the Commission as long as it is only a minimum standard thereby ensuring that Denmark can maintain the existing version of the principle. Following this, the Danish government can support the proposal if our system entailing absolute priority in both the cover pool and against the issuer's estate can be maintained.

The Danish government acknowledges the need for addressing the concerns regarding asset encumbrance in universal banks issuing covered bonds. Asset encumbrance in universal banks can be a concern as encumbered assets become unavailable to support the resolution of credit institutions in accordance with BRRD, which may increase credit losses for unsecured creditors. However, in specialised mortgage credit institutions there are no depositors and, following this, creditors are only bondholders or junior creditors. Therefore, rules giving the bond investors a direct claim in the cover pool and in the credit institutions estate will not have the same consequences for the unsecured creditors as in a universal bank.

A future framework should not prevent a dual recourse giving the bondholders a direct claim against the cover pool as well as a direct claim against the issuer's estate. There is no need for prudential concerns related to asset encumbrance for specialised mortgage institutions since these institutions are not allowed to take deposits. Given the different situations for universal banks we do, however, understand why a different solution may be needed as the general rule.

3.2. Segregation of cover assets

3.2.1. 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?

Please see the answer to 2.1.3

3.2.2. 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?

In Denmark, the legal and practical steps to segregate assets are the same in the case of a going concern as in case of insolvency or resolution.

For universal banks issuing covered bonds, the Financial Business Act states that universal banks, which have been granted a licence to issue covered bonds directly, shall establish and maintain a group of assets, which shall be held separate from the other assets of the bank, and that the universal bank shall keep registers of the assets. Supplementary collateral shall be registered separately and individualised as well. The supervisory authority shall verify the existence of the assets.

Specialised mortgage credit institutions have similar rules. The mortgage credit institution can grant mortgage credit loans and issue covered bonds in series, called capital centres, each having an individual serial reserve fund (which is separate capital related to the series). The funds of the serial reserve fund shall remain separate from the other funds of the mortgage credit institution. An executive order defines detailed rules for the series.

The registers and the capital centres are upheld in case of insolvency or resolution. A trustee is appointed by The District Court (the department handling bankruptcy cases) immediately and at the same time the bankruptcy court decides to initiate either bankruptcy proceedings or restructuring proceedings, and the trustee will control the upholding of the registers and the capital centres. There is therefore no need for further steps in order to segregate the cover assets.

The initiation of the insolvency or resolution proceedings is announced publicly. The trustee is obliged to inform the creditors individually on an ongoing basis.

In relation to the last question on the legal status, proceeds of the cover assets will remain in the estate and, if related to a register or a capital centre, will be kept in the register or a capital centre.

3.3. Administration of the cover pool post insolvency/resolution of the issuer

3.3.1. Legal form and supervision of the cover pool

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

In our view, there is no need for incorporating the cover pool as a regulated entity. We find that such a requirement would entail considerable costs as the cover pools should in this case e.g. meet all capital requirements (including all buffer requirements), all liquidity requirements, establish a board etc. We do not find that the benefits entailed in such a requirement are high enough to compensate for these significantly added costs.

We acknowledge that it is mandatory to secure the cover pool in insolvency/resolution, but we find that this can be handled by upholding the same procedures securing the cover pool in case of a going concern as in the case of insolvency/resolution.

In Denmark, the balance sheets of Danish mortgage credit institutions are structured with a number of separate and ring-fenced cover pools out of which covered bonds are issued. Most Danish mortgage institutions have several cover pools on their balance sheets. A requirement of 8 % RWA must be complied with by the mortgage institutions as a whole, but also by the individual cover pool.

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

The competent authority should be the supervisory authority in insolvency/resolution in cooperation with the appointed trustee.

When handling issues relating to resolution according to the BRRD, the resolution authority should be the relevant authority.

3.3.2. Special administration of the cover pool

3.3.2.1. 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?

The Danish government can support the content of the proposals on the appointment and legal regime for a cover pool special administrator. In Denmark such a cover pool special administrator would be the appointed trustee.

However, if made part of an integrated covered bonds framework it is vital that the wording leaves room for national insolvency rules. E.g. the notion that the special administrator would be "an officer of the court" can intervene with the set-up of the national courts, where a trustee in Danish legislation is a lawyer and not an officer of the court. We, however, find that a broader demand for the administrators to be "only those that may act as insolvency practitioners in each Member State would be eligible to be appointed" would set a sufficiently high standard without the need for harmonisation of the national insolvency rules. We therefore support the latter.

3.3.2.2. 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 should be obliged to report regularly to the relevant supervisory authority and in the Danish perspective to the creditors as well. This reporting is to ensure that the competent authority is able to follow the proceedings and ensure the financial regulation is respected.

The content of the reporting to the competent authority should be the same as for the issuer in a going concern, however without reporting strictly linked to a going concern, e.g. issuing of new loans or bonds.

Furthermore, we find that the reporting provided to the creditors should be sufficient for the creditors and especially the bondholders to safeguard their interests. This means that the level of details should make the creditors feel ensured that the trustee is exercising the principal duty of the trustee to preserve and maximise the net value of the estate for the benefit of the creditors while minimising the ongoing liabilities and costs associated with its administration.

3.3.3. Ranking of cover pool liabilities

3.3.3.1. 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?

The suggested ranking for cover pool liabilities can be supported by the Danish government. This is the same ranking as in Denmark.

In an integrated framework it is important that the rules on ranking of claims in national insolvency rules are respected. The rules on ranking that are suggested in subsection 3.3 of part III seem to leave room for deciding to have one or more of the claims not being ranked pari passu with the bond holders. As the possibility of absolute priority to expenses incurred by the special administrator or the liquidator is also kept, the necessary room for incorporating national insolvency rules seems to be secured. This is important for the Danish government.

The wording proposed in subsection 3.3 of Part III defines the claims clearly. We can therefore support the wording proposed.

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

It could be considered to specify the description of hedging instruments to include instruments covering risks between assets and corresponding covered bonds issued. Furthermore, it could be considered specifying that the derivatives should not be terminated upon issuer insolvency. The EBA covered bonds report defines this latter element as best practice regarding the use of derivatives.

3.4. Interaction between cover pool and issuer in insolvency/resolution

3.4.1. 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?

At this point of time, it is difficult to give a general answer to these questions.

3.4.2. Should the Framework provide for a cut-off mechanism as suggested in subsection 3.4 of Part III? In particular, should such a cut-off mechanism:

a) preclude the closure of insolvency or resolution before possible residual claims from the covered bondholders against the issuer or the insolvent estate have been identified and quantified?

b) set out clear and objective requirements on the valuation of the cover pool and the timing for such valuation?

c) extinguish the residual claim on the estate or the successor credit institutions after sufficient assets have been segregated for the benefit of covered bondholders at the outset of the resolution or insolvency proceedings?

d) give specific powers and duties to the resolution authority and, if so, what should those consist in?

In Denmark, specialised insolvency rules enable a non-forced winding down of the mortgage credit institution ultimately up to the residual term of the outstanding covered bonds. The Danish government wishes to keep this possibility for a non-forced winding down of the mortgage credit institution. Therefore, we do not support harmonized EU-rules requiring a cut-off mechanism.

We can, however, accept that a possibility for a cut-off mechanism is included in the framework as long as we can still keep our non-forced and gradual winding down of the mortgage credit institution.

This being said, the use of a cut-off mechanism should at all times respect the principle of dual recourse as carried out in each Member State. It is moreover essential that the use of a cut-off mechanism does not interfere with the principle of no creditor worse off as this is a fundamental principle in the BRRD.

4. The cover pool

4.1. Eligible assets: qualifying criteria and requirements

4.1.1 Residential and commercial loans

4.1.1.1 Do you agree with the proposed definitions for "residential" and commercial loans" as cover assets? Should certain riskier residential or commercial loans (i.e. 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?*

Regarding the first question, the Danish government agrees with the definitions. We do, however, not see any need to require a first rank as long as the loan stays within the LTV-limit. This view is elaborated under point 4.1.1.2.

Regarding the question of excluding certain riskier loans from the cover pool, the Danish government is open to discussing a more differentiated LTV approach towards the different real estate segments. This being said, we do not support excluding loans from the cover pool. Unlike universal banks, specialised institutions cannot move loans with exceeding LTV-limits or non-performing loans from the cover pool – either in whole or in part. Instead Danish specialized institutions need to add additional cover assets / liquidity in the cover pool

Following the above, excluding loans from the cover pool is simply not possible in specialised mortgage credit institution using a match funding principle. An exclusion from the cover pool would require the use of other loan funding instruments, which are not present in non-deposit taking Danish specialised mortgage credit institutions.

4.1.1.2 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?*

In regards to the latter question; yes. Registration of the security is needed to secure the claim against new subsequent mortgages.

As long as the mortgage stays within the LTV limit there should be no requirement for first ranks since loan amounts within the LTV limit can be regarded as secure lending.

Furthermore, a requirement for first rank could hamper competition in the market because it would exclude the possibility of additional loans by other credit institutions. This would be the case as the credit institution having provided the first loan would have the first rank thereby making it impossible for the next credit institution to provide a loan with first rank.

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

The Danish government is not in possession of knowledge of the situation in the different Member States.

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

Equivalent standards should apply for mortgages in third countries. This is important for ensuring equal competition as well as ensuring covered bonds of a sufficiently high standard.

4.1.1.3 In relation to LTVs:

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

The Danish government is in favour of a regulation setting stricter LTV limits for certain commercial property segments than for residential property. Following this, we support that the LTV limits are 80 and 60 per cent for residential and commercial property, respectively, as is the case today.

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?

The Danish government finds it natural with a requirement, as is the case today, of a sufficient insurance coverage. This is necessary to ensure the mortgage. This should, however, not imply higher LTV limits as the focus would then be removed from the property towards an exposure on an insurance company. We find that LTV limits should be inflexible in the sense that they should always be observed.

In our view, LTI requirements should never replace LTV limits since this would also remove focus from the property. Furthermore, a meaningful measure would have to include the full financial picture of the borrower including wealth. Following this logic, we find that LTI requirements should not be regulated in a covered bond framework.

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

Is is unclear to us how such a requirement should be specified. Our position on this issue depends on the exact calibration. We are, however, not convinced on the added value of 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?*

The Danish government is in favour of market value.

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?*

LTV-limits should be used to determine eligibility of loans at inception. Certain national systems like the Danish specialist banking principle do not make it possible to take the loans in and out of the cover pool depending on actual LTV. This is due to the loan and the corresponding covered bonds being inextricably tied together.

In case of LTV breaches of a loan, additional security in the form of supplementary collateral should be supplied. This requirement could be based on the underlying risk, i.e. taking account of different loan loss scenarios. However, for specialised mortgage credit institutions loans cannot be taken out of the cover pool due to the match funding principle. Furthermore, an exclusion from the cover pool would require the use of other loan funding instruments, which are not present in non-deposit taking Danish specialised mortgage credit institutions.

4.1.1.4 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)?*

The Danish government is satisfied with the existing set-up concerning frequency and possibility for revaluation based on statistic methods. Following this, we can support that commercial property should be revaluated every year and that residential property should be revalued every third year. We see no need for revaluing all properties every year. In our view yearly revaluation of both commercial and residential property would be very burdensome.

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?*

The Danish government is in favour of a general requirement for a skilled and experienced valuer independent of the credit granting process. This implies that the valuer can be an employee of the mortgage credit institution, which is the common situation in Denmark. The Danish FSA supervises the work of these valuers on an on-going basis.

4.1.1.5 Should the Framework adopt the definition of "non-performing exposures" as set out in the EBA's draft Implementing Technical Standards on Supervisory Reporting on Forbearance and Non-performing Exposures?

The Danish government is flexible on the matter but notes that we do not support excluding non-performing loans from the cover pool if measures to secure sufficient asset cover (i.e. supplementary collateral matching the specific write-downs on the cover assets) are applied.

In the Danish mortgage credit model it is not possible to take out non-performing loans of the cover pool. This being said, the value of the loan shall of course be adjusted accordingly and eventually additional security in the form of supplementary collateral will have to be supplied to the cover pool to account for the loan impairment charges.

4.1.1.6 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?

The Danish government sees no need for inclusion of such asset types in the cover pool.

In Denmark, out of these instruments only joint funding instruments are allowed. This is the case when one mortgage bank in a group issues all the covered bonds for all mortgage banks in the group secured by a specially formed mortgage deed giving the issuing mortgage bank access to the mortgages in the funded mortgage bank (i.e. covered bonds backed by other covered bonds). This results in a situation completely comparable to one where all the loans would originally all be funded in the issuing mortgage bank.

4.1.2 Public sector loans

4.1.2.1 What are your views on the proposals for public sector loans as cover assets set out in subsection 4.1 of Part III?

The Danish government is comfortable with the existing possibility according to Article 129 to include public sector loans in the cover pool. The Danish government is however also open for adjustments on this issue.

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

The Danish government finds that the guarantee should ideally be in the form of surety from a public sector entity backed by tax imposition. We find this necessary in order to make it a very secure eligible asset.

4.1.3 Other asset class: Aircraft, ship and SME loans

4.1.3.1 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?

The Danish government is comfortable with the existing possibility of allowing ship mortgages within a lending limit of 60 percent of the ship value. However, mortgages in real estate should not be mixed with mortgages in e.g. ships since these asset classes are too different in kind.

4.1.3.2 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?

The Danish government prefers to restrict the potential asset classes to what is the case today. We, therefore, do not support identifying a category of SME loans which can be an eligible asset class for cover pools.

4.1.4 Mixed pools and limits on exposures

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

The Danish government agrees that mixed-assets cover pools should be allowed in the sense that e.g. mortgages on residential property can be mixed with mortgages on other types of properties. This can mitigate concentration risks.

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

In general, the Danish government finds that additional analysis is needed in this area.

4.2 Coverage requirement and overcollateralisation

4.2.1 Coverage requirement

4.2.1.1 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 Danish government is in favour of a market value principle. The market value of the issued covered bonds should (apart from OC) be covered by assets of a similar market value.

4.2.1.2 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?

4.2.1.3 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?

Derivatives entered into for hedging purposes should be an integral part of the cover pool and valued at market value. In this way they would serve their hedging purpose at all times.

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

Exposures towards credit institutions in the form of guarantees, provisional investments made with revenue from issued covered bonds or in the form of exposures from derivatives for hedging purposes – both within the 15 pct. limitation on such exposures – should be taken into account in the determination of the coverage requirement.

4.2.2 Overcollateralisation

4.2.2.1 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 general, the Danish government finds that such requirements should be risk based. That is, the capital requirements based on risk weighted exposures in the cover pool would be appropriate and consistent with the regulation in general.

In Denmark there is a requirement of 8 % RWA for each cover pool in specialised mortgage institutions. This requirement can be seen as an OC requirement.

In case a mandatory minimum OC requirement should be set at EU level, it needs to be carefully considered how to define this requirement and how large it should be.

If an OC requirement is set the framework should furthermore state the method for calculating OC, e.g. is it a NPV calculation on future margins or is it a nominal requirement.

4.2.2.2 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)

The Danish government believes that further analysis is needed in this area.

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

For specialised banks that are not allowed to take deposits a maximum level does not seem relevant since for practical purposes there are no other creditors than the covered bond investors and junior creditors. Asset encumbrance is, therefore, not a practical issue here.

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

The Danish government believes that a covered bonds framework should be specific on the status of voluntary OC in the event of insolvency/resolution of the issuer. Furthermore, it should be possible to grant the voluntary OC an absolute priority upon default of the issuer.

This being said, one should be careful in defining voluntary OC as this can be many different things. Is voluntary OC for an example the OC described in a prospect? Or the OC required in relation to agreements with rating agencies, etc.

4.3 Market and liquidity risks

4.3.1 *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?*

No. The Danish government believes that it is necessary to supplement an OC requirement with risk profile limitations measured on differences between future payments on the issued covered bonds and the future payments on mortgages and derivatives for hedging purposes in areas like interest rate risk, FX risks and options risks.

In the Danish specialised banking model, the balancing principle effectively limits both liquidity and market risk, leaving room mainly for credit risks within the strict LTVs.

In general, two types of “funding models” exist in the Danish mortgage credit system. One possibility is to finance the mortgage loans with covered bonds with the same maturity as the loans – i.e. 30 year mortgage loans are financed with covered bonds with a 30 year maturity. Another possibility is to finance the loans with covered bonds with a maturity which is shorter than the maturity of the loans. Following this, 30 year mortgage loans are financed with covered bonds with a maturity of e.g. 1, 3 or 5 years. In this case, the mortgage loans are refinanced continually (every 1, 3 or 5th year).

In April 2014 a new law was implemented in Denmark regulating the refinancing risk inherent in the refinancing of a large amount of the mortgage loans. The law implies that if the refinancing of a loan fails, the existing bonds will be extended by 12 months at a time ultimately throughout the lifetime of the underlying loans. Following this, refinancing of mortgage loans is always possible and the refinancing risk is moved from the mortgage credit institutions to the investors.

Besides this law, the Danish FSA has set up a so-called supervisory diamond for mortgage credit institutions. The supervisory diamond sets a number of benchmarks to indicate activities which initially should be regarded as having a higher risk profile. For mortgage credit institutions the benchmarks include i.e. an indicator regarding the proportion of loans with frequent refinancing, borrower's interest-rate risk and large exposures.

4.3.2 *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?*

The Danish government believes that the use of derivatives should be confined to hedging purposes. Eligibility of derivatives counterparties could be based on ratings.

4.3.3 *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?

4.3.4 *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?

It is the opinion of the Danish government that the possibility of liquidity risks in a covered bond arrangement should be limited to an insignificant level. This can be obtained in several ways e.g. through OC requirement or specific liquidity requirements or combinations hereof.

In Denmark, the balancing principle effectively limits both liquidity and market risk, leaving room mainly for credit risks within the strict LTVs.

Furthermore, as already mentioned, in April 2014 a new law was implemented in Denmark regulating the refinancing risk inherent in the refinancing of a large amount of the mortgage loans. The law implies that if the refinancing of a loan fails, the existing bonds will be extended by 12 months at a time ultimately throughout the lifetime of the underlying loans. Following this, refinancing of mortgage loans is always possible and the refinancing risk is moved from the mortgage credit institutions to the investors.

Besides this, the Danish FSA has introduced a supervisory diamond for mortgage-credit institutions, cf. above.

> *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?*

Please see answer to a). Mitigation of liquidity risks can be achieved in several ways.

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

In the light of the purpose of such a buffer a requirement for secure and liquid securities like covered bonds, claims on central governments or central banks could be a possibility.

5 Transparency requirements

5.1 *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?*

The Danish government agrees with the importance of disclosure to the market on specifics of the assets in the cover pool. In this connection the disclosure provisions in paragraph 7 of Article 129 are a good starting point. Nevertheless, improvement in the direction of a more granular level could be sought like e.g. according to the European Covered Bond Council project on a cross-border harmonized template.

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

The Danish government believes in transparency as an important precondition for an efficient market. Disclosure of information on counterparties involved in a covered programme could be beneficial. We have at present no specific indications on what kind of information is sought by investors in this field.

5.3 *How frequently should covered bond issuers be required to make disclosures to investors?*

The Danish government has no firm view on the matter but believes as a matter of principle that if investors express reasonable disclosure requirements these requirements should be complied with.

As stated in the answer to question 5.1 the existing templates prepared by the industry could be a good starting point for the mapping of what kind of information investors seek. However, it is also important to stress that in a new regulatory set-up system should be flexible in light of the fact that investors over time must be expected to demand new types of information. The current set up with Article 129(7) and a harmonized template could therefore be a way forward.

When deciding on requirements for disclosure to investors related to covered bonds the general information requirements related to the securities market should furthermore be taken into account.

5.4 *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?*

As pointed out under question 5.3 the existing set up could be sufficient but before making any conclusions the industry should be consulted.

5.5 *Should detailed disclosure requirements apply to all European covered bonds or only to those that would fall within the scope of the Prospectus regime?*

Covered bonds receiving the same treatment should ideally be subject to the same requirements including disclosure requirements. Prospectus regulation should apply in addition to this.

5.6 *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)?*

At this stage the Danish government sees no reason to distinguish between the need for disclosure standards applying pre- and post-insolvency/resolution. The disclosure obligation towards investors could therefore be the same in both cases.

5.7 *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?*

The Danish government believes that justification of preferential risk weights should in all cases be based on the same level of disclosure.