

# Covered Bonds Rules

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## REVISIONS LOG

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# 1. Introduction and Scope

- 1.1 These Rules shall apply to covered bonds issued by credit institutions licensed in terms of the Banking Act (Chapter 371 of the Laws of Malta).
- 1.2 These Rules should be read in conjunction with the Financial Markets Act (Chapter 345 of the Laws of Malta), the Financial Markets Act (Covered Bonds) Regulations (S.L. 345.27), and the applicable provisions of the Recover and Resolution Regulations (S.L. 330.09) (the "RRR").

# 2. Definitions

- 2.1 Unless otherwise specified below, terms used and defined in the Act, the CBR and the RRR shall have the same meaning in these Covered Bonds Rules. In addition, for the purposes of these Covered Bonds Rules:

"applicant" means a credit institution which intends to issue a covered-bond programme;

"bail-inable liabilities" shall have the same meaning as that defined in regulation 2 of the RRR;

"BRRD" means Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council, as amended from time to time;

"CBR" means the Financial Markets Act (Covered Bonds) Regulations (S.L. 345.27);

"CRR" means Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, as amended from time to time;

"FMA" means the Financial Markets Act (Cap. 345 of the Laws of Malta);

"Loan" for the purpose of these Rules, means a loan secured by residential and/or commercial properties as referred to in Article 129(1) (d) and (f) of the CRR;

"Resolution Committee" shall have the same meaning as defined in regulation 2 of the RRR;

"RRR" means the Recovery and Resolution Regulations (S.L. 330.09);

"SRMR" means Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010, as amended from time to time; and

"the Authority" means the Malta Financial Services Authority acting in its supervisory capacity;

### 3. Application Process

- 3.1 A credit institution which intends to issue covered bonds, shall submit an application to the MFSA in the format specified by the Authority, providing relevant details of the proposed covered bond programme and demonstrate how each of the requirements will be complied with.
- 3.2 In the absence of an application form, the credit institution shall still provide relevant details of the proposed covered bond programme and demonstrate compliance with each of the applicable requirements.
- 3.3 Where required, applicants shall obtain written advice and reports from suitably qualified and experienced independent third-party advisers, attesting compliance with relevant legislation, regulation and/or Rules as the case may be.
- 3.4 Applications for a covered bond programme shall *inter alia* be accompanied by:
- (a) an adequate programme of operations setting out the issue of covered bonds;
  - (b) policies, processes and methodologies aimed at investor protection for the approval, amendment, renewal and refinancing of loans included in the cover pool;
  - (c) a copy of the organisational structure of the applicant showing the management and staff dedicated to the covered bond programme, including details of their respective qualifications and knowledge regarding the issue of covered bonds and the administration of the covered bond programme;
  - (d) the audited financial statements for the last three years, as applicable;
  - (e) an updated business plan and a description of business continuity arrangements taking into consideration the intended covered bond programme;
  - (f) the composition of the cover pool for the covered bond issuance, the administrative set-up of the cover pool demonstrating clearly the monitoring arrangements put in place to meet the requirements of the Act and all Rules issued thereunder;
  - (g) the identity and full particulars of the cover pool monitor, including information on the knowledge, skills and experience relevant to the role;
  - (h) in the case of collateral assets located outside the Union, an external and independent legal/expert opinion confirming or otherwise whether the realisation of those collateral assets is legally enforceable in a way which is equivalent in effect to the realisation of collateral assets located in the European Union;

(i) any other document or information which the Authority may require from time to time.

Pursuant to point (g) of this paragraph, the cover pool monitor shall complete and submit to the Authority a Personal Questionnaire for the Authority to conduct a suitability assessment.

3.5 Unless otherwise specified, all documents and information relating to the application, shall be provided to the Authority in electronic format.

## 4. Ongoing Requirements

4.1 Credit institutions whose covered bond programme has been approved by the Authority shall adhere to the following requirements on an ongoing basis.

### Eligible Cover Assets

4.2 Covered bonds issued by a credit institution shall be secured by the following cover assets:

- a) Loans secured by residential immovable property in accordance with Article 129(1)(d) of the CRR;
- b) Loans secured by commercial immovable property in accordance with Article 129(1)(f) of the CRR;

### Cover Pool

4.3 The cover pool shall consist of at least 80% of eligible primary assets, and a maximum of 20% substitution assets. Substitution assets can only be included in the cover pool for a maximum of 20% of the total nominal value of the cover assets. These substitution assets can be comprised of the types of eligible cover assets under Article 129(1) (d) and (f) of the CRR.

4.4 If the credit institution has a claim to a loan on a property which it acquired to prevent any future losses, the loan may be considered as cover only on the basis of a new calculation of the lending value.

4.5 Loans may be used as cover only up to the first 60% of the value of the property (lending value) established by the credit institution on the basis of a valuation.

4.6 Should building structures connected firmly with the property be taken into account as augmenting the lending value of the loan, it must be ensured during the full lending term that, in case any such building is damaged or destroyed, the credit institution receives insurance payment for compensation of loss, insofar as the building is not rebuilt or restored. The insurance must at a minimum cover those risks which are significant according to the location and type of property. The amount of the insurance must cover at least the following:

- i. The expected cost to rebuild or restore buildings;
- ii. The amount of damages which would in all likelihood not be exceeded in the event that such significant risks to the buildings referred to above should occur; or
- iii. The amount of the loan claim outstanding, limited to the time value loss that the credit institution would have received from a value-adequate building insurance policy in the event of loss.

## Joint Funding

- 4.7 Pursuant to regulation 6 of the CBR, credit institutions issuing covered bonds shall ensure that cover assets which were originated by a credit institution or another undertaking and that have been purchased by the credit institution issuing the covered bond, shall comply with all requirements in the Act and any Rules issued thereunder.

## Valuation of Physical Collateral Assets

- 4.8 Pursuant to regulation 3(5) of the CBR, physical collateral assets, which secure assets as referred to in sub-regulations (1)(a) and (b) of the same regulation, shall be valued at the moment of inclusion in the cover pool. At the point in time of inclusion of the cover asset in the cover pool, there shall exist for each physical collateral asset: a current valuation at, or at less than, market value or lending value of the loan.
- 4.9 The valuation shall be carried out by a valuer who possesses the necessary qualifications, ability and experience, and who is independent from the credit decision process.
- 4.10 The valuer shall not take into account speculative elements in the assessment of the value of the physical collateral asset and shall document the value of the said asset in a transparent and clear manner.
- 4.11 The valuation of the collateral asset:
- a) shall not exceed the market value calculated in a transparent manner and using a recognised valuation method, and
  - b) shall not exceed the value resulting from a prudent assessment of the future marketability of the immovable property by taking into account the long-term sustainable aspects of the property, the national market conditions, as well as the current and possible alternative uses.
- 4.12 The value of the immovable collateral asset shall be monitored and reviewed in accordance with Article 208(3) of the CRR.

## Collateral Assets Located Outside the Union

- 4.13 Pursuant to regulation 4 of the CBR, credit institutions shall:
- a) ensure that collateral assets located outside the Union are subject to an equivalent regulatory regime in the jurisdiction where such collateral assets are located,
  - b) ensure that the value of the assets in the cover pool secured by collateral assets located outside the Union constitute not more than 50% of the total value of assets included in the cover pool, and
  - c) consider and assess the volatility of the market being considered, and the application of adequate haircuts when deemed necessary.

## Cover Pool Monitor

- 4.14 A credit institution issuing covered bonds is required to appoint a cover pool monitor in respect of each covered bond programme. The cover pool monitor shall generally be separate and independent from the credit institution and the credit institution's external auditor, unless expressly authorised by the Competent Authority after sufficient safeguards are put in place in line with regulation 10(3) of the CBR.
- 4.15 A cover pool monitor shall not be appointed prior to the Authority's approval of such appointment.
- 4.16 The credit institution issuing the covered bond shall propose the appointee to the Authority for its approval after having conducted its own due diligence checks and ascertained that the proposed appointee is a fit and proper person, and possesses the necessary expertise, skills and experience needed to fulfil the role and duties of a cover pool monitor.
- 4.17 The credit institution shall notify the Authority immediately following the resignation of the cover pool monitor. Such notification shall include interim arrangements and plans moving forward with respect to the role itself as well as the responsibilities for the necessary decision-making related to this role. The credit institution shall then report to the Authority, on a regular basis, any interim decisions taken and on developments with regards to the recruitment process.
- 4.18 The resigning cover pool monitor shall submit a signed declaration to the Authority attesting whether the resignation was due to regulatory reasons or otherwise.
- 4.19 The cover pool monitor is responsible to ensure that:
- a) the prescribed cover for the covered bonds exists at all times. In so doing the cover pool monitor shall ensure that the value of the collateral assets is established according to Rules 4.8 to 4.12;
  - b) the cover assets for the covered bonds are recorded in a cover register;



- c) a certificate (in physical or electronic form), confirming that the prescribed cover exists and has been recorded in the relevant cover register, is issued for each covered bond issue.
  - d) assets recorded in the cover register may be amended or deleted from the cover register only with the express agreement of the cover pool monitor. This approval must be recorded in writing if the cover register is maintained in paper form or electronically if the cover register is maintained in electronic form. An amendment or deletion without the requisite agreement shall be deemed null and ineffective.
- 4.20 The cover pool monitor shall inform the Competent Authority of significant findings and observations in the course of carrying out its duties in terms of Rule 4.19 or when requested by the Authority.
- 4.21 The cover pool monitor may inspect the records of the credit institution issuing covered bonds and may instruct the credit institution issuing covered bonds to provide such information and data as it reasonably requires in the performance of its duties in so far as it relates to the covered bonds and the assets recorded in the cover register.
- 4.22 The credit institution issuing covered bonds shall keep the cover pool monitor informed of the principal repayments relating to the assets recorded in the cover registers as well as of other changes relating to these assets that are of relevance to the covered bond holders at such times as the cover pool monitor requires.
- 4.23 The cover pool monitor shall notify the Authority, as soon as it becomes aware, that the credit institution issuing covered bonds, appears to be in breach of the applicable legislation, regulations or Rules and shall further divulge the extent of such non-compliance.
- 4.24 If the Authority so directs, the cover pool monitor shall provide such information as to the exercise and performance of its duties as required from time to time.
- 4.25 The cover pool monitor shall be entitled to a remuneration for the work and to compensation of appropriate expenses incurred. The remuneration shall be based on the costs and efforts of the cover pool monitor, the duration of the covered bond programme and the nominal value of the covered bonds in question.
- 4.26 When a special administrator is appointed pursuant to Rule 5.1, the duties of the cover pool monitor shall be suspended until the term of the special administrator has ended. The cover pool monitor remains obliged to provide the special administrator with all such information as might be of relevance to the administration of the cover assets.

## Coverage

- 4.27 The total amount of outstanding covered bonds must be always covered by cover assets of at least an equal amount.

- 4.28 All liabilities of the covered bonds shall be covered by claims for payment that are linked to the covered assets. The liabilities shall include:-
- i. Obligation for the payment of the principal amount of outstanding covered bonds ;
  - ii. Obligation for the payment of any interest on outstanding covered bonds ;
  - iii. Expected costs related to maintenance and administration for the ending and liquidation of the covered bond programme.
- 4.29 The following cover assets contribute towards coverage requirement:-
- i. Primary assets ;
  - ii. Substitution assets ; and
  - iii. Liquid assets.
- 4.30 The calculation of the required coverage shall ensure that the aggregate principal amount of all cover assets is equal to or exceeds the aggregate principal amount of the liabilities of the covered bonds.

## Interest Payable

- 4.31 The calculation of interest payable on outstanding covered bonds and any interest receivable on cover assets shall be carried out with sound prudential principles in accordance with applicable accounting standards.
- 4.32 The interest payable on covered bonds shall be calculated based on the nominal value of the bonds and the fixed or variable interest rate specified in the bond terms. The interest shall be paid semi-annually or annually.

## Interest Receivable

- 4.33 The Interest Receivable on loans used as cover assets, shall be calculated based on the outstanding principal and the interest rate agreed upon in the loan contract. The interest shall be accrued monthly and added to the cover pool.

## Reporting

- 4.34 Credit institutions issuing covered bonds shall submit to the Authority the information set out in sub-regulation 3 of regulation 15 of the CBR for each bond issuance separately.
- 4.35 Credit institutions issuing covered bonds shall submit the information referred to in Rule 4.34 to the Authority on a quarterly basis, as the information stands on the following reporting reference dates: 31 March, 30 June, 30 September and 31 December.

- 4.36 Credit institutions issuing covered bonds shall submit the information referred to in Rule 4.34 to the Authority by close of business on the following respective remittance dates: 30 April, 31 July, 31 October and 31 January.
- 4.37 If the remittance date falls on a public holiday, a Saturday or a Sunday, the information shall be submitted to the Authority on the following working day.
- 4.38 First reporting to the Authority by credit institutions issuing covered bonds shall be on the first remittance date as specified in Rule 4.36 that falls immediately after the covered bond issuance. In the event that the date of the covered bond issuance is after the respective reference date, then the date of the covered bond issuance shall be used as reference date for the first reporting.
- 4.39 The Authority may request the information referred to in Rule 4.34 to be submitted with a higher frequency or on an ad-hoc basis, if and when it deems so appropriate. In such cases, the request shall be communicated in writing, specifying the respective remittance dates.
- 4.40 Credit institutions issuing covered bonds shall ensure that any information submitted to the Authority is correct, clear and sufficiently structured.
- 4.41 Where quantitative information is submitted to the Authority, credit institutions issuing covered bonds may submit unaudited figures. Where audited figures deviate from submitted unaudited figures, the revised audited figures shall be submitted to the Authority without undue delay. For the purpose of these Covered Bonds Rules, unaudited figures are figures that have not received an external auditor's opinion whereas audited figures are figures audited by an external auditor expressing an audit opinion.
- 4.42 Credit institutions issuing covered bonds shall submit any other corrections to the information that has been previously submitted to the Authority without undue delay, for one or more reference dates as applicable.
- 4.43 The Authority may request clarifications on the information submitted to it by issuers of covered bonds. The Authority may request the information to be resubmitted to it by issuers of covered bonds, if and when it identifies errors, lack of clarity, anomalies and/or potential data quality issues.
- 4.44 In the event of insolvency or resolution of the credit institution issuing covered bonds, the special administrator shall be responsible to submit the required information to the Authority.
- 4.45 In addition to the information referred to in Rule 4.34, the Authority may request credit institutions issuing covered bonds to submit to it other information as may be deemed necessary. The Authority may also request additional information in the event of insolvency or resolution of the credit institution issuing covered bonds. In such cases, the request shall be communicated by the Authority in writing, establishing the applicable frequency, reference dates and remittance dates.

## 5. Requirements in the Event of Insolvency or Resolution

### Special Administrator

- 5.1 In carrying out public supervision on covered bonds in the event of the insolvency or resolution of a credit institution which has issued covered bonds, the Authority may appoint a special administrator pursuant to Article 39L of the FMA. In exercising such power, the Authority shall consult with the Resolution Committee in connection with the appointment and/or dismissal of any special administrator made in terms of these Rules. In appointing the special administrator, the Authority shall ensure that the person so appointed is a fit and proper person possessing the knowledge and experience necessary to fulfil its duties outlined in these Rules.
- 5.2 The special administrator shall execute his duties under the oversight of the Authority. When exercising his duties, the special administrator shall provide the Authority with all relevant information as it may deem necessary.
- 5.3 The duties of the special administrator shall be to:
- a) monitor the recoverability of the individual cover pools at regular intervals;
  - b) fulfil all managerial functions with due care;
  - c) request the credit institution issuing covered bonds to perform all acts and legal transactions necessary of the winding up of the cover pool;
  - d) act as an observer in instances where the Resolution Committee decides to affect a transfer in terms of the RRR including the transfer of the business of the credit institution issuing covered bonds, whether in whole or in part. This provision shall also apply in the event that a tool is used in terms of Article 24 to 26 (both Articles included) of the SRMR.
- 5.4 More specifically, the special administrator shall be responsible for:
- a) the management of the cover pool of the credit institution issuing covered bonds which is subjected to limited business activity;
  - b) collecting claims of covered bond investors according to the maturity of the respective bonds;
  - c) transfer all or part of the collateral assets of the credit institution issuing covered bonds to another credit institution issuing covered bonds, subject to obtaining the prior written consent of the Resolution Committee.
- 5.5 In exercising the duties in terms of these Rules, the special administrator shall:
- a) have the power to process personal data so long as it is necessary in the performance of the role's duties / tasks;
  - b) have the power to make use of the staff members of the credit institution issuing covered bonds in order to perform such tasks.

- c) ensure that, when exercising the function under Rule 5.4 (c), the transfer agreement contains, as a minimum:
  - i) the name of the credit institution transferring the covered bonds and its head office address (transferor) and the name and head office address of the credit institution receiving the covered bonds (transferee);
  - ii) an agreement as to the assets that will be transferred together with their corresponding liabilities from the transferor to the transferee and, where applicable, the consideration (attached thereto);
  - iii) the correct denomination of the assets and liabilities to be transferred from the transferor to the transferee.

5.6 The special administrator shall be entitled to a remuneration for the work and to compensation of appropriate expenses incurred. The remuneration shall be based on the costs and efforts of the Special Administrator, the success of the winding up in terms of value and of the nominal value of the covered bonds in question.

5.7 If, by way of act or omission in exercising such duties and responsibilities, the special administrator acts negligently or with wilful misconduct (in breach of Rule 5.3 (b)), the special administrator shall have the appointment terminated and be held liable for damages to the credit institution issuing covered bonds. The special administrator shall be deemed not to be in breach if a reasonable justification proving the actions taken were for the benefit of the covered bond investors is provided.

## Public Supervision in the event of Insolvency or Resolution

5.8 Covered bonds are not bail-inable liabilities by virtue of regulation 44(2)(b) of the RRR (which implements the equivalent provisions in Article 44 of the BRRD), and, accordingly, in the event of a resolution action being taken by the Resolution Committee vis-à-vis a credit institution issuing covered bonds, a special administrator shall manage the business of that credit institution in respect of the cover pool in consultation with the Resolution Committee or any administrator that may be appointed by the Resolution Committee pursuant to the RRR. The appointed special administrator must seek the prior written approval of the Resolution Committee prior to transferring the cover pool.

5.9 In the event of insolvency or resolution of a credit institution issuing covered bonds, the Authority shall co-operate with the Resolution Committee to ensure that the rights and interests of a holder of covered bonds are preserved, including by verifying the continuous and sound management of the covered bond programme during the period of the resolution process.

5.10 Without prejudice to Rules 5.3 to 5.5, the special administrator shall have the powers to administer the business of the credit institution issuing covered bonds as listed hereunder:

- a) the discharge of the liabilities attached to the covered bonds;
- b) the management and realisation of cover assets, including their transfer together with covered bond liabilities to another credit institution issuing covered bonds;

- c) the legal transactions necessary for the proper administration of the cover pool, for the ongoing monitoring of the coverage of liabilities attached to covered bonds, for the initiation of legal proceedings in order to bring assets back into the cover pool and for the transferal of the remaining assets to the insolvency estate of the insolvent issuer undergoing normal insolvency proceedings after all covered bond liabilities have been discharged.

## Extendable Maturity Structures

- 5.11 A special administrator appointed in terms of Rule 5.1 may, in consultation with the Resolution Committee or any person appointed to act on its behalf, only elect to provide for an extension of the maturity of a covered bond in circumstances, where the special administrator reasonably concludes that:
- a) the credit institution issuing covered bonds is likely to become subject to a potential resolution action pursuant to the RRR, or is likely to be subjected to insolvency proceedings; and
  - b) the extension of any maturity profile of an applicable covered bond, including payments of interest and principal during the extension period, will adequately compensate covered bond investors for the delay in meeting the original payment schedule of any applicable covered bond.
- 5.12 The maturity date can only be extended by the special administrator, after consulting with the Resolution Committee subject to the fulfilment of the following conditions:
- a) The extension of the maturity date is necessary in order to prevent the imminent insolvency of the issuer that is subjected to limited business activity;
  - b) The total period of extension of the maturity date does not exceed one year;
  - c) The issuer subjected to limited business activity is not overindebted; and
  - d) It is highly likely that the credit institution issuing the covered bond subjected to limited business activity will be able to meet its liabilities when they fall due after the expiration of the maximum extension date, taking into account further possibilities for extension.
- 5.13 The special administrator shall, in the case of listed covered bonds, ensure that any decision taken (in terms of Rule 5.11) to extend the maturity date is published by the credit institution issuing covered bonds, in accordance with applicable legislation, regulations and Rules.

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