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Chapter 13
Covered Bonds

R.A. Stegeman & J.C. Westermann***

13.1. INTRODUCTION[1]

13.1.1. Covered Bonds in a Nutshell

Covered bonds are generally bonds which are (a) issued by a bank, and (b) collateralised ('covered') by a pool of high quality cover assets. Investors in covered bonds have dual recourse: first to the issuing bank and thereafter, if the issuing bank cannot perform, to the cover assets. Due to their dual recourse nature and certain additional safeguards,[2] covered bonds are regarded as very safe instruments for investors. For issuing banks covered bonds are a means of attracting long-term, relatively cheap funding. As the covered bonds are collateralised by cover assets, the issuing bank usually needs to pay less interest than it would have to pay on uncovered bonds.

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1. For more detailed information on covered bonds generally please see the European Covered Bond Factbook which is freely available on the internet (<www.ecbc.hypo.org>).
2. Such as eligibility criteria for cover assets, rules on the minimum level of 'over-collateralisation' (meaning in short the amount by which the value of the cover assets exceeds the outstanding principal amount of the covered bonds), regulatory supervision, rating agency surveillance and protection mechanisms against market and liquidity risk.

Marcel C.A. van den Nieuwenhuijzen, *Financial Law in the Netherlands*, pp. 387–409.

The main purpose of collateralising the covered bonds by cover assets is to ensure that even if the issuer becomes insolvent, the cash flows under the covered bonds are not disrupted or accelerated.[3] In other words, the intent is that when the issuer becomes insolvent, the cover assets generate sufficient and timely cash flows to ensure that the covered bondholders will not only get their money back, but will also receive the relevant payments of principal and interest on the originally scheduled payment dates. The cover assets are usually mortgage loans or public sector loans (such as government bonds).

13.1.2. History

Covered bonds have a long history, going back to the eighteenth century and before. They have their roots in ancient Greek mortgage lending and Dutch and Italian bonds. In the nineteenth century covered bonds played an important role for bank funding across Europe. That changed in the course of the twentieth century, when covered bonds became less important as the inter-bank market and private bank deposits grew.

In 1995 jumbo covered bonds were introduced. ‘Jumbo’ in short means that the covered bonds (a) have a total issuance size of at least 1 billion; (b) are euro-denominated; and (c) have a bullet maturity and a fixed annual coupon.[4] The first jumbo covered bonds were issued out of Germany.[5] In the Netherlands the first jumbo covered bonds were issued in 2005, by ABN AMRO.

Following the introduction of jumbo covered bonds, the covered bond market has become the most important segment of privately issued bonds in the European capital markets. The total volume of covered bonds outstanding as per the end of 2008 was approximately EUR 2.4 trillion for covered bonds issued out of Europe and EUR 21 billion for covered bonds issued out of the Netherlands.

13.1.3. Credit Crunch

Initially when the credit crunch started in 2007, covered bonds were relatively resilient. That changed with the collapse of Lehman Brothers on 15 September 2008. Thereafter (a) issuance of jumbo covered bonds stopped for the remainder of 2008, (b) secondary trading of covered bonds was hampered because market

3. ‘Acceleration’ of a debt means that, due to for example the insolvency of the debtor, the creditor demands full and immediate payment of the entire outstanding balance of the debt prior to the scheduled maturity of such debt.
4. ‘Bullet maturity’ and ‘fixed annual coupon’ mean that the bonds are to be repaid in one instalment on their maturity date and carry interest which is payable annually at a fixed rate.
5. German covered bonds are called *Pfandbriefe*.

making by traders[6] (which had already seen various interruptions since the start of the credit crunch) shut down completely and (c) spreads widened considerably.[7]

In some European countries governments introduced specific national measures to enable covered bond issuance even when the market was closed, ranging from government guarantee schemes (e.g., Ireland) to special central bank repo schemes (e.g., Denmark and Sweden) and government asset purchase schemes (e.g., the UK). In the Netherlands a government guarantee scheme was introduced too, but it enabled government guarantees for uncovered bank bonds only, and not for covered bonds.

In January 2009 the covered bond market was one of the first non-state guaranteed bank debt capital markets to come back to life, although initially at interest rate levels which were so high that they were previously thought impossible for covered bonds. The market has been recovering slowly but surely since. It was kick-started when the European Central Bank (ECB) announced its EUR 60 billion covered bond purchase programme in May 2009.[8] Under that programme covered bonds issued within the euro area are purchased by the ECB in the primary and secondary market to help reviving the market.

13.1.4. Regulated versus Contractual Covered Bonds

In most European countries, covered bond issuance is regulated by specific regulation implementing the relevant provisions of the UCITS Directive and the CRD.[9] In the Netherlands, covered bond regulation was implemented relatively late, in 2008. In this respect a distinction needs to be made between covered bonds which are issued pursuant to such specific covered bond regulation (*Regulated Covered Bonds*) and covered bonds which are issued outside the scope of such specific covered bond regulation (*Contractual Covered Bonds*).

Until about seven years ago the jumbo covered bond market consisted exclusively of Regulated Covered Bonds. This changed in 2003, when the first jumbo Contractual Covered Bonds were issued out of the UK. At the time no specific covered bond regulation existed in the UK. The Contractual Covered Bonds were eyed with suspicion by some traditional issuers of Regulated Covered Bonds. They

6. Under the Dutch Financial Supervision Act (*Wet op het financieel toezicht*; FSA) a 'market maker' is in short defined as a party presenting itself in the financial markets as willing to buy and sell financial instruments at prices defined by it.
7. 'Widening of spreads' in short means that investors would only purchase covered bonds in the primary or secondary market if the covered bonds carried interest rates or yields that were substantially higher than before.
8. Decision of the European Central Bank of 2 Jul. 2009 on the implementation of the covered bond purchase programme (ECB/2009/16).
9. UCITS Directive means the Undertakings for Collective Investment in Transferable Securities Directive (85/11/EEC). CRD means the Capital Requirements Directives, comprising (a) the Banking Consolidation Directive (2006/48/EC; the BCD), and (b) the Capital Adequacy Directive (2006/49/EC; the CAD).

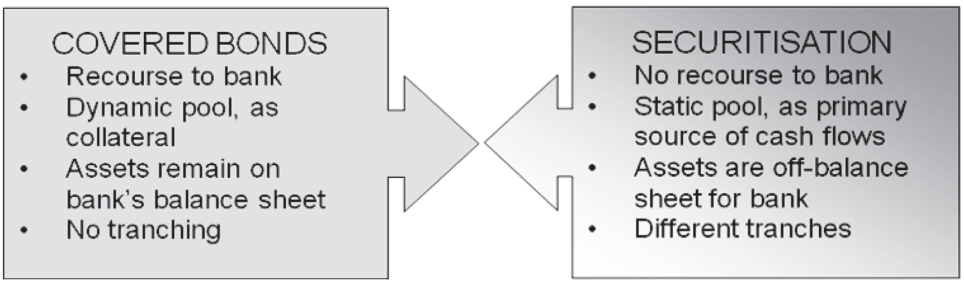
feared, among other things, that the widening of the spectrum of covered bond categories might result in a widening of the spreads[10] payable on their covered bonds. However, the Contractual Covered Bonds met with enthusiasm from many other banks and investors and the UK example was soon followed by banks from other countries such as Canada, France, Germany, Italy, Switzerland, the US and the Netherlands (starting with ABN AMRO in 2005).

Like the UK, the Netherlands did not have specific covered bond regulation when the first jumbo Contractual Covered Bonds were issued. Since the introduction of specific Dutch covered bond regulation in 2008, most of the Dutch Contractual Covered Bonds have been registered by the Dutch Central Bank (*De Nederlandsche Bank N.V.*; DNB) and have thus become Regulated Covered Bonds.

13.1.5. Covered Bonds versus Securitisation

Covered bonds and securitisation are different animals. For example, covered bonds are issued by a bank, whereas securitisation notes are issued by a special purpose vehicle. Also, the cover assets backing covered bonds remain on the balance sheet of the bank and are a dynamic pool, the quality and quantity of which is actively managed by the bank for as long as it is solvent. The pool of assets backing a securitisation on the other hand, is usually a static pool which is removed from the balance sheet of the bank (resulting in regulatory capital relief for the bank[11]). Furthermore, covered bonds typically rank *pari passu* between themselves, whereas in a securitisation the highest credit risk is concentrated in the subordinated tranches of notes. The main differences between covered bonds and securitisation can be summarised as set out in Figure 13.1.

Figure 13.1. Main Differences Between Covered Bonds and Securitisation



10. For a description of what ‘widening of spreads’ means, see *supra* n. 7.
11. ‘Regulatory capital relief’ in short means that a bank is allowed to reduce its (supervisory) own funds (*toetsingsvermogen*), since the part of the (supervisory) own funds that was required in relation to the relevant assets as a buffer to be able to cope with potential losses in respect of such assets is no longer necessary. Own funds are relatively expensive for a bank.

That said, there is a number of similarities between covered bonds and securitisation. For example, both are used by banks as a funding tool and both are backed by assets. As a result, some of the topics which are relevant for this Chapter 13, are already addressed in Chapter 12 (*Securitisation*) of this book. To prevent overlap, this chapter will in a number of places refer to the relevant paragraphs of Chapter 12.

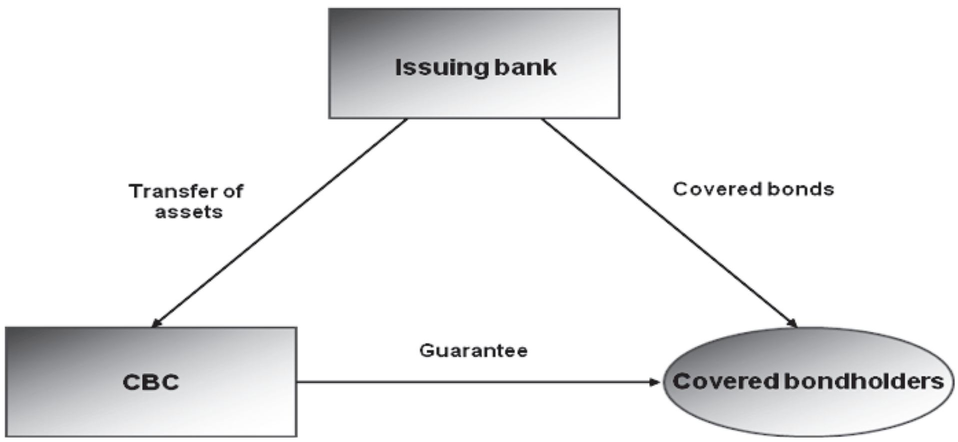
13.2. HOW COVERED BONDS WORK

13.2.1. Segregated Structure

The basic elements of the Dutch covered bond structure can be visualised as set out in Figure 13.2.

In short the bank issues covered bonds to the covered bondholders and transfers cover assets to a special purpose vehicle called a covered bond company (the CBC).[12] The covered bonds are unsecured bonds which are guaranteed by the CBC, meaning in short that if the issuing bank defaults, the CBC will instead of the issuing bank make payments of scheduled principal and interest to the covered bondholders.[13] The above structure is called a 'segregated' structure because the

Figure 13.2. Basic Elements of Dutch Covered Bond Structure



12. For a more detailed description on special purpose vehicles generally please see para. 12.3 (*Dutch Special Purpose Vehicles*) of this book.
13. For a more detailed description of the guarantee see para. 13.2.3 (*Guarantee*) below. The guarantee is secured by a right of pledge over the assets owned by the CBC. Strictly speaking the right of pledge is unnecessary, as a right of pledge is predominantly relevant in case of a

cover assets are segregated from the issuing bank. The segregated structure needs to be distinguished from an 'integrated' structure, where the cover assets continue to be owned by the bank and no CBC is involved.[14] In a Dutch law integrated structure the bank would issue the covered bonds to the covered bondholders and pledge the cover assets to the covered bondholders (or a trustee acting on their behalf) as security for its payment obligations under the covered bonds.

There are mainly two reasons why Dutch covered bonds are issued under a segregated structure. Firstly, when the first Dutch Contractual Covered Bonds were being structured for ABN AMRO in 2005, investors had seen Contractual Covered Bonds from the UK only, which are issued under a segregated structure. It made sense to offer those investors something they were already familiar with and thus to stay close to the UK example.

Secondly, the segregated structure works with a transfer (*overdracht*) rather than a pledge (*verpanding*), as would be used in an integrated structure. For investors, a pledge has a number of disadvantages when compared to a transfer, including that a pledgee could be subjected to (a) a cooling-off period (*afkoelingsperiode*); and (b) a request from the liquidator to liquidate the cover assets within a reasonable term.[15] Such a cooling-off period or premature liquidation could disrupt the cash flows originated by the cover assets and needed for payments to the covered bondholders. Those disadvantages of a pledge when compared to a transfer are one of the reasons why following the re-introduction into Dutch law of the concept of silent assignment in 2004, a transfer structure based on silent assignment developed into the better practice for Dutch true sale securitisations over the old structure ultimately relying on a pledge.[16] Although the abovementioned disadvantages of a pledge could be addressed by structural solutions which could be implemented in an integrated structure, a segregated structure is more straightforward and more in line with Dutch securitisation techniques which the rating agencies, regulator, originators and investors are familiar with. In the Dutch covered bond regulation the Dutch regulator stated that it will only accept a segregated structure for covered bonds.[17]

When 'Dutchifying' the UK covered bond structure, one structural simplification was introduced. In the UK structure (like in a securitisation) the CBC is a

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bankruptcy of the CBC, whereas the CBC is a bankruptcy-remote entity. The main reason why the right of pledge is created in practice nevertheless is that there is generally no objection against creating it and that rating agencies, regulators and market participants prefer a belts-and-braces approach, for the unlikely scenario that the CBC goes bankrupt or the CBC (represented by its management) for any reason does not comply with its obligations under the transaction documents. For a description on creation and enforcement of security for note holders, see para. 12.8 (*Transaction Security*) of this book.

14. An example of covered bonds using an integrated structure are German *Pfandbriefe*.
15. Sections 63a and 58, respectively, of the Dutch Bankruptcy Code. For a more detailed description see also para. 12.8.4.2 (*Impact of Insolvency on Security*) of this book.
16. The old structure works with a notified assignment with postponed notification and backed by a silent pledge, as described in Ch. 12 (*Securitisation*), see *infra* n. 37.
17. See para. 13.3.4 (*Regulated Covered Bonds*) under (a) below.

central player through which all cash flows are channelled: on 'day 1' the issuing bank on-lends the issuance proceeds to the CBC, which the CBC in turn applies to pay the issuing bank a purchase price for the cover assets; on each subsequent payment date the principal and interest proceeds generated by the cover assets are (like in a securitisation) applied by the CBC to pay amounts of principal and interest in respect of the funding it received (in a securitisation under the notes from investors; in a covered bond structure under the loan from the issuing bank). When the Dutch structure was developed, it was felt to be somewhat synthetic to channel the cash flows through the CBC. After all, (unlike in a securitisation) in a covered bond structure (a) the CBC is only a substitute player which does not require any cash flows unless the issuing bank defaults and the guarantee is activated; and (b) the issuing bank funds its payments under the covered bonds from its general financial means and does not specifically require the proceeds generated by the cover assets to be able to pay principal or interest in respect of the covered bonds. Therefore, when the Dutch covered bond structure was developed, it was felt to be somewhat synthetic to require the issuing bank to lend monies to the CBC so as to enable the CBC to pay a purchase price back to the issuing bank. For that purpose a guarantee support agreement was introduced which made the requirement for a purchase price and the associated synthetic cash flows redundant. The guarantee support agreement allowed ABN AMRO and subsequent Dutch issuers (to date Achmea, ING, NIBC and SNS) to present a simple and transparent structure to investors.

13.2.2. Guarantee Support Agreement

The guarantee support agreement is an innovative instrument which was tailor-made for Dutch covered bond structures. It is an agreement between the issuing bank and the CBC. It serves as a legal basis (*titel*) for the transfer of cover assets by the issuing bank to the CBC. The actual transfer is effectuated by way of a delivery (*levering*), which could take the form of for example an assignment (if the cover assets are registered claims such as residential mortgage receivables) or book-entry transfer (if the cover assets are book-entry securities such as government bonds).

In the guarantee support agreement the issuing bank agrees to transfer the cover assets to the CBC as consideration for the CBC issuing the guarantee and so as to enable the CBC to perform its obligations under the guarantee. In return, the CBC agrees that for as long as it is not required to make payments under the guarantee, the issuing bank may: (a) continue to collect and retain the proceeds on the cover assets; and (b) request a retransfer of cover assets as long as, following the retransfer, the CBC still has sufficient cover assets to perform its obligations under the guarantee.[18] If the CBC becomes obliged to make payments under the guarantee (a) the authority to collect and retain the proceeds on the cover assets

18. For determining whether the CBC has sufficient assets from time to time, an asset cover test is run on a monthly basis, as described in more detail in para. 13.2.4 (*Cover assets*) below.

shifts to the CBC; and (b) the issuing bank will no longer be entitled to request retransfers of superfluous cover assets and will basically have no other right than to receive any remaining cash from the CBC after all covered bondholders and other senior and junior creditors of the CBC have been paid in full in accordance with the applicable priority of payments. The guarantee support agreement does not qualify as a sale and purchase, donation or exchange agreement or any other type of special agreement (*bijzondere overeenkomst*) listed in Book 7 or 7A of the Dutch Civil Code (*Burgerlijk Wetboek*; DCC). It is an agreement of its own kind (*sui generis*).

The guarantee support agreement is not invalidated by section 3:84(3) DCC,[19] which prohibits two types of legal acts.

Firstly, it prohibits legal acts which purport to transfer assets by way of security. The transfer of cover assets by the issuing bank to the CBC is not a transfer by way of security. Making sufficient assets available to a company so as to enable that company to perform its obligations towards third parties does not have anything to do with a security transfer. The purpose of a security transfer is to grant a creditor a right to take recourse to certain assets of its debtor with priority over other creditors of that same debtor.[20] The CBC is not a creditor of the bank and does not require recourse to assets of the bank. There might still be an argument to state that the guarantee support agreement is invalidated by section 3:84(3) DCC if there are ancillary circumstances from which it should be concluded that the parties' intention was to circumvent section 3:84(3) DCC.[21] Insofar as we are aware no such circumstances exist. Preferring a segregated over an integrated structure can in itself not serve as an ancillary circumstance from which it should be concluded that the parties intended to circumvent section 3:84(3) DCC: the segregated structure (involving the CBC as a third party co-debtor) is further removed from a security transfer than a sale and financial lease-back structure (involving only a debtor and its creditor, being the purchaser, financier and lessor of the relevant assets), against which the Supreme Court saw no principal objections in the Sogelease case.

Secondly, section 3:84(3) DCC prohibits legal acts lacking the intent to transfer the assets to the transferee. The guarantee support agreement does not lack the intent to transfer the cover assets to the CBC; its main purpose is to transfer cover assets to the CBC. The transfer enables the CBC to, should the need arise, collect proceeds on, and sell or refinance, as appropriate, the cover assets and to perform its payment obligations under the guarantee. The guarantee support agreement grants the issuing bank some contractual rights in respect of the cover assets, being the right to: (a) collect and retain proceeds; and (b) request a retransfer of superfluous cover assets, but only for as long as the CBC is not required to make payments under the guarantee. In the Sogelease case the Dutch Supreme Court confirmed that the above prohibition on legal acts which lack the intent to transfer

19. For a different and unsustainable view, see A.F. Salomons & M.G. van 't Westeinde, *WPNR* (2008/6758).
20. Dutch Supreme Court, 19 May 1995, *NJ* 1996, 119 (Sogelease), consideration 3.4.4.
21. *Ibid*.

the assets to the transferee, does not invalidate an arrangement in which one party (in this case the CBC) owns the assets and the other party (in this case the issuing bank) has contractual rights and obligations only.[22]

13.2.3. Guarantee

Under the guarantee the CBC undertakes to pay to the covered bondholders amounts of scheduled principal and interest due under the covered bonds, which can be explained in more detail as follows. In first instance the issuing bank is obliged to pay amounts of principal and interest on the covered bonds. The guarantee is activated only, in short, if the issuing bank fails to pay principal or interest on the covered bonds, in which case the covered bonds will be accelerated[23] against the issuing bank only. As a result of the acceleration, the issuing bank will be obliged to repay the total principal amount of all covered bonds then outstanding together with all outstanding interest. As the issuing bank will be in financial difficulty by the time the covered bonds are accelerated against it, it is unlikely that the issuing bank will be able to repay all covered bonds together with outstanding interest. Should any amount of principal or interest be received from the issuing bank (or its liquidator in insolvency), then such amount will not be applied to repay principal or pay interest to the covered bondholders, but will be paid to, and added to the cover assets owned by, the CBC. The amounts so received from the issuing bank (or its liquidator in insolvency) (a) will discharge the obligation of the issuing bank in respect of the covered bonds for the equivalent of the amount received; and (b) will, like any other cash flows available to the CBC, be used by the CBC to make payments of scheduled principal and interest to the covered bondholders. The general intent is that even though the position of the issuing bank may deteriorate, the covered bondholders will continue receiving payments of principal and interest on the payment dates originally scheduled for the covered bonds. In other words, the CBC and the asset-backed guarantee are in place so as to bring the covered bonds to the finish line even if the issuing bank becomes insolvent.

Generally covered bonds provide for one bullet repayment at maturity, and not for instalment repayments of principal during the term of the covered bonds. Some covered bonds are issued with a ‘soft bullet’ maturity, which means that under the guarantee the CBC is permitted to extend the maturity of the covered bonds by one year. That possible extension option is available only to the CBC (and not to the issuer) and only in respect of final redemption amounts payable by the CBC (and not to payments of interest). Covered bonds without such a possible maturity extension under the guarantee are called covered bonds with a ‘hard bullet’ maturity.

22. See consideration 3.6 of the Sogelease case.
23. For an explanation of what ‘acceleration’ of a debt means, see *supra* n. 3.

It is possible that a covered bondholder wishes to transfer its covered bonds to a transferee. In such circumstances, the transferee will together with the covered bonds wish to acquire the corresponding rights under the guarantee. Due to the independent nature of the payment obligations of the CBC under the guarantee, the guarantee qualifies as an independent payment undertaking and not as a suretyship (*borgtocht*). That means that from the perspective of the covered bondholders, the guarantee is an independent claim and not an accessory right (*afhankelijk recht*), and is unlikely to be an ancillary right (*nevenrecht*), which in turn means that the guarantee does not by operation of law follow the receivables it secures upon a transfer thereof. Such an 'automatic' transfer of the guarantee, can in the case of bearer (*toonder*) covered bonds be accomplished by ensuring that the guarantee forms an integral part of the covered bonds. For that reason the guarantee and the covered bonds provide that the rights under the guarantee (a) form an integral part of the covered bonds; (b) are of interest to a holder of covered bonds only if, to the extent that, and for so long as, it holds covered bonds; and (c) can only be transferred together with all other rights under the relevant covered bond. As a result, in case of a transfer of a covered bond to a transferee by way of a book-entry transfer (*girale overboeking*) or physical transfer of a bearer covered bond, such transfer includes the corresponding rights under the guarantee. For covered bonds which are registered (*op naam*), the rights under the guarantee are to be separately assigned, together with the corresponding rights under the relevant registered covered bonds.

13.2.4. Cover Assets

The cover assets are owned by the CBC, but from an accounting perspective the cover assets continue to be on the consolidated balance sheet of the issuing bank, which continues to carry the credit risk of the cover assets. To date all Dutch covered bond programmes are backed by residential mortgage loans.[24] In addition they allow for inclusion of other types of cover assets called 'substitution' assets, meaning euro-denominated (a) cash; or (b) subject to minimum rating and maximum percentage requirements (this differs per programme), other assets eligible under the CRD to collateralise covered bonds. All programmes allow for inclusion of non-Dutch residential mortgage loans, subject to certain restrictions. In practice all cover pools consist of Dutch residential mortgage loans and, in one programme (NIBC), German residential mortgage loans.

One of the obligations of the issuing bank is to ensure that the CBC has sufficient cover assets to be able to meet its payment obligations under the guarantee. For this purpose an asset cover test is run on a monthly basis. The asset cover test intends to calculate the ratio of the cover assets owned by the CBC to the covered bonds issued by the issuing bank. If the CBC owns

24. For a more detailed description on the peculiarities of transferring residential mortgage loans see, for example, paras 12.4.3 (*Security*) and 12.4.4 (*Selected Legal Issues*) of this book.

insufficient cover assets, the issuing bank is obliged to transfer more cover assets to the CBC. When calculating the value of the CBC's cover assets on a monthly basis under the asset cover test, certain deductions are made so as to, among other things, account for certain risks.[25]

13.2.5. Asset and Liability Management

Under all current Dutch covered bond programmes swaps are entered into at two levels: first a total return swap at the cover pool level and then interest rate or structured swaps at covered bond issuance level. The total return swap is entered into at inception of the programme and basically swaps the different types of interest[26] to be received on the cover assets to one month's EURIBOR (the Euro Interbank Offered Rate). In addition, an interest rate swap or structured swap is entered into each time a series of covered bonds is issued under a programme. The interest rate/structured swap basically swaps one month's EURIBOR/euro's to the interest rate/currency payable under the relevant series of covered bonds. In cases where the issuing bank has a high credit rating, the issuing bank may opt to postpone the entering into of such interest rate and structured swaps until the occurrence of certain rating trigger events.

All Dutch covered bond programmes to date require the issuing bank to establish a reserve fund equal to one month's interest payments on the covered bonds plus certain costs and expenses for one month if the issuing bank's short term rating is or falls below P-1/F1/A-1 or A-1+ (this differs per programme).

To mitigate liquidity risk on principal payments all Dutch covered bond programmes to date use either:

(a) a pre-maturity test which is taken on each business day during the following number of months preceding the maturity of the relevant covered bonds:
    (i) if the rating agency Standard & Poor's rates the covered bonds, six months; and/or
    (ii) if the rating agency Moody's and/or Fitch rates the covered bonds, twelve months.

    The pre-maturity test is failed if on the relevant test date the issuing bank's short term rating is or falls below P-1/F1+/A-1+. A breach of the pre-maturity test requires (x) the issuing bank to cash-collateralise covered bonds with a hard bullet maturity;[27] or (y) the CBC to procure alternative

25. For example the deduction risk that applies to residential mortgage loans which are combined with an insurance policy with a capital element, as described in para. 12.4.4.2 (*Set-Off and Deduction*) of this book.
26. For example, the underlying residential mortgage loans may carry fixed and floating rates at different levels and for different interest periods.
27. For an explanation on what 'hard' and 'soft' covered bonds are, see para. 13.2.3 (*Guarantee*) above.

remedies such as a guarantee of the issuing bank's obligations, a liquidity facility and/or a sale or refinancing of cover assets; or

(b) the possibility of a one-year maturity extension (i.e., covered bonds with a soft bullet maturity).[28]

For all Dutch covered bond programmes a minimum level of over-collateralisation[29] is required, which is measured by applying asset percentages ranging from approximately 87.5% to 94% in the asset cover test. That translates into a minimum degree of over-collateralisation of 6.3% to 14.3% (this differs per programme).

13.3. SPECIFIC COVERED BOND REGULATIONS

13.3.1. Section 22(4) UCITS Directive

Under the UCITS Directive, a UCITS[30] may not invest more than 5% of its assets in transferable securities or money market instruments issued by a single issuing bank. In 1988 the UCITS Directive was amended to increase the 5% limit to 25% for investments in covered bonds. At the same time a definition of covered bonds was introduced in section 22(4) UCITS Directive:

> (. . .) certain bonds (. . .) issued by a credit institution which has its registered office in a Member State and is subject by law to special public supervision designed to protect bond-holders. In particular, sums deriving from the issue of these bonds must be invested in conformity with the law in assets which, during the whole period of validity of the bonds, are capable of covering claims attaching to the bonds and which, in the event of failure of the issuing bank, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.

Until 2008 the Netherlands knew no law that provided for '*special public supervision designed to protect bondholders*' as required by section 22 (4) UCITS Directive. That meant that Dutch issuing banks could issue Contractual Covered Bonds only and not Regulated Covered Bonds, which put them at a disadvantage to covered bond issuers from most other European countries. As will be explained in more detail below, under different areas of European financial market regulation prudential investment limits are eased if an investment is made in Regulated Covered Bonds rather than Contractual Covered Bonds.

28. *Ibid*.
29. For an explanation of what 'over-collateralisation' means, see *supra* n. 2.
30. A 'UCITS' means an undertaking for collective investment in transferable securities (*instelling voor collectieve belegging* or *icbe*).

13.3.2. Consultation Process

In an effort to create a level playing field for Dutch banks, in June 2003 a working group consisting of the Dutch Bankers' Association and DNB took the initiative and sent a proposal for a Dutch covered bond law to the Dutch Ministry of Finance, together with a report comparing different covered bond regulations from other European countries. Despite external pressure from various sources the Ministry of Finance did not give Dutch covered bond regulation much priority at the time. ABN AMRO Bank N.V. decided not to await the requested regulation and issued the first ever Dutch Contractual Covered Bonds in 2005.

In or around February 2006 Dutch covered bond regulation was put back on the agenda at the Ministry of Finance, presumably fuelled by renewed external pressure and the momentum created by the consultation on English covered bond regulation that was started by the Financial Services Authority at about the same time. In those days the UK and the Netherlands were among the very few European countries that did not have specific covered bond regulation yet. In September 2006 the Ministry of Finance issued a press release announcing that covered bonds regulation would be implemented in the Netherlands, that a first draft of the regulation would be ready in the first half of 2007 and that the regulation would enter into force one year thereafter, depending on Parliament.

From April 2007 a number of working group meetings was held involving the Ministry of Finance, DNB, the Dutch Bankers' Association, issuing banks and law firms active in the covered bond market. In November 2007 the Ministry of Finance opened a public consultation with the market on a draft regulation for Dutch covered bonds (the *Regulation*). On 1 July 2008 the Regulation came into force.

13.3.3. Regulatory Framework

The Regulation aims to:

- provide Dutch issuing banks with a level playing field with other issuers of covered bonds within the European Union;
- facilitate a market in safe instruments in accordance with the applicable European directives; and
- impose solid conditions to protect covered bondholder interests.

The Regulation embraces the segregated structure, and does not recognise an integrated structure.[31] Under the Regulation, asset segregation takes place on the basis of the Dutch Civil and Bankruptcy Codes. The applicable statutory provisions in the Dutch Civil and Bankruptcy Codes are relatively creditor-friendly and have enabled the Ministry of Finance to take a time-efficient and principles-based approach without the need to have the Dutch Civil or Bankruptcy Code amended.

31. Both structures are explained in para. 13.2.1 (*Segregated Structure*) above.

The Regulation is not a separate instrument but a collection of rules forming part of two layers of secondary regulation implementing the FSA:

(a) the Decree on Prudential Rules FSA (*Besluit prudentieel toezicht Wft*); and
(b) the FSA Implementing Regulation (*Uitvoeringsregeling Wft*).

There is however a third Dutch regulation which contains specific covered bond provisions, being the Regulation on Solvency Requirements for Credit Risk FSA (*Regeling solvabiliteitseisen voor het kredietrisico Wft*; the Solvency Requirements FSA). An important distinction to bear in mind is that the Regulation focuses on issuance of covered bonds by Dutch banks out of the Netherlands, whereas the relevant Solvency Requirements FSA focus on investment by Dutch banks (and investment firms) in covered bonds issued out of any country that is part of the European Economic Area. The Solvency Requirements FSA are a number of years older than the Regulation and stipulate the regulatory beneficial treatment for investments in covered bonds that are backed by 'CRD-compliant' cover assets. *CRD-compliant* cover assets are basically cover assets that meet the requirements of item 68 of Annex VI to the BCD (which together with the CAD constitutes the CRD).[32]

The relevant provisions of the Regulation and the Solvency Requirements FSA are listed in Table 13.1.[33]

Table 13.1. Relevant Provisions of the Regulation and the Solvency Requirements FSA

Applicable regulation	*Relevant sections*	*Explanatory notes*
Decree on Prudential Rules FSA (*Stb.* 2006, 519)	Sections 1 (definitions of 'registered covered bond' and 'covered bond'),124a, 124b and 124c	*Stb.* 2008, 210 (the Decree Explanatory Notes)
FSA Implementing Regulation (*Stcrt.* 2006, 230, 20)	Sections 1 (definitions of 'offering programme', 'application', 'covered bond' and 'legal advisor'), 20a, 20b and 20c	*Stcrt.* 2008, 121, 10

32. It is beyond the scope of this Ch. 13 to address all requirements imposed by the CRD and the Solvency Requirements FSA on the cover assets backing Regulated Covered Bonds in detail. The applicable CRD requirements in short prescribe which types of debtor and asset are eligible and what maximum limit applies to certain types of assets. Two points to note are that the Solvency Requirements FSA erroneously (a) refer to a 'recognised covered debt instrument' instead of 'registered covered bond' in the definition of 'covered bond'; and (b) do not refer to commercial mortgage-backed securities as eligible assets to back Regulated Covered Bonds in Annex 1 thereto.

33. In addition, s. 135(1) Decree on Conduct of Business of Financial Undertakings FSA (*Besluit gedragstoezicht financiële ondernemingen Wft*) permits higher investment limits for investments in covered bonds by UCITS.

Table 13.1. (cont'd)

Applicable regulation	*Relevant sections*	*Explanatory notes*
Solvency Requirements FSA (*Stcrt.* 2006, 248, 2)	Sections 1:1 (definition of 'covered bond'), 2:38, 2:39, 2:40, 3:44(1)(c), 4:29(2), 7:8(2)(g), 8:1, 8:2 and Annex 1	*Stcrt.* 2006, 248, 2

13.3.4. Regulated Covered Bonds

The Regulation defines a covered bond[34] basically by prescribing six general criteria that follow from section 22(4) UCITS Directive as interpreted and implemented by the Ministry of Finance:

(a) *it is issued by a bank*[35] *having its registered office in the Netherlands.* That excludes banks operating in the Netherlands on a cross-border basis (*verrichten van diensten*) or through a branch office (*bijkantoor*). Subsidiary companies of a Dutch licenced bank are not eligible to act as issuing bank, even if their obligations are guaranteed by their parent bank and they are included in the consolidated supervision on that parent bank.[36] Consequently, group financing companies (*financieringsmaatschappijen*) having their registered office in the Netherlands and relying on an exemption from the statutory bank licence requirement pursuant to section 3:2 FSA are not capable of issuing Regulated Covered Bonds. The issuing bank must be licenced and subject to full ongoing supervision by DNB;

(b) *it is covered by cover assets which will be used with priority towards payment of principal and interest on the covered bonds if the issuing bank defaults.* The Regulation acknowledges that certain costs need to be made so as to ensure that the covered bondholders are fully and timely paid. The Regulation therefore allows certain proceeds of the cover assets to be applied towards certain higher ranking payment obligations of the CBC

34. Section 1 Decree on Prudential Rules FSA.
35. The UCITS Directive definition of a covered bond refers to a 'credit institution' (*kredietinstelling*) rather than a 'bank'. Under the FSA 'bank' is a more appropriate term, as 'credit institution' is a collective term covering both banks and electronic money institutions. Electronic money institutions are restricted in their activities and would never be able to issue covered bonds (see s. 3:34 FSA). In this context it should be realised that s. 22(4) UCITS Directive was created long before electronic money institutions were included in the definition of credit institution in the BCD.
36. See s. 6 of the Decree Explanatory Notes.

such as those relating to: (i) the management and administration of the cover assets; and (ii) derivative contracts.[37] In some European countries (such as the UK) the legislator or regulator has taken a less flexible approach towards the relevant component of section 22(4) UCITS Directive and has required that no obligation of the CBC (or its foreign equivalent) may rank senior to the payment of principal and interest on the covered bonds;

(c) *the cover assets have been safeguarded for the benefit of the covered bondholders by way of a transfer to a CBC and a pledge to a trustee*.[38] The transfer may occur on a universal legal basis (*algemene titel*; such as a demerger (*afsplitsing*)) or a special legal basis (*bijzondere titel*; such as a transfer (*overdracht*) pursuant to a guarantee support agreement) and the transfer may be governed by foreign law. Instead of a right of pledge (*pandrecht*) a comparable foreign law security right may be created. Alternative ways of safeguarding the cover assets for the covered bondholders are also permitted, as long as they are approved by a ministerial regulation. However, at the time the Regulation came into effect, the Ministry of Finance and DNB seemed to oppose an integrated structure, due to the disadvantages which a pledge has compared to a transfer from the perspective of the covered bondholders;[39]

(d) *the cover assets provide sufficient cover for the payment of principal and interest on the covered bonds and the cost of managing and administering the cover assets*;

(e) *the cover assets are governed by the law of a Member State, the United States of America, Canada, Japan, the Republic of Korea, Hong Kong, Singapore, Australia, New Zealand or Switzerland*; and

(f) *the issuing bank does not own or control the CBC or the trustee*. The CBC and the trustee must be special purpose vehicles[40] and may be foreign legal entities.

13.3.5. UCITS- & CRD-Compliance

Although the Solvency Requirements FSA contain detailed provisions on cover assets as prescribed by the CRD, the Regulation only lists the general requirements of section 22(4) UCITS Directive. The Regulation therefore introduces CRD-compliance as an option, and not as a requirement. In covered bond regulation across Europe that is a novel feature. It allows issuing banks of (and thus investors in)

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37. See the Decree Explanatory Notes, under item b of the covered bond definition.
38. A 'trustee' is in short a party representing and looking after the interests of the covered bondholders vis-a-vis the issuing bank. In the Netherlands it usually takes the form of a special purpose foundation (*stichting*).
39. For a description of these disadvantages, see para. 13.2.1 (*Segregated Structure*) above.
40. For an information source on special purpose vehicles, see *supra* n. 12.

Regulated Covered Bonds the flexibility to choose whether they wish to issue (or invest in) Regulated Covered Bonds which are either:

(a) compliant with the UCITS Directive (*UCITS-compliant*); or
(b) both UCITS-compliant and CRD-compliant (*UCITS- & CRD-compliant*).

The above novel feature of CRD-compliance as an option, should be seen against the background that the CRD prescribes that covered bonds may be backed by residential mortgage loans only up to the lesser of (a) the principal amount of the relevant mortgage right; and (b) 80% of the value of the underlying mortgaged property. However, relevant Dutch residential mortgage loans may in practice have a loan-to-value (LTV) ratio of up to 125%. To date all Dutch covered bond programmes take a two-step approach towards LTV-ratio's of Dutch residential mortgage loans, as follows:

(a) a loan is only eligible to be transferred to the CBC if its principal amount did not exceed 125% (subject to some exceptions in some programmes; the *Eligibility Percentage*) of the value of the mortgaged property at origination; and
(b) once a loan forms part of the cover assets of the CBC, the maximum value attributed to it in the asset cover test is a certain percentage (this differs per programme; the *LTV Cut-Off Percentage*) of the value of the underlying mortgaged property at such time. For example, if: (i) the relevant LTV Cut-Off Percentage is 80%; and (ii) a residential mortgage loan has a principal amount of 110 and is backed by mortgaged property with a value of 100, then such loan would be valued at no more than 80 in the asset cover test. The 30 excess value of the loan would serve as extra credit enhancement. The LTV Cut-Off Percentage applied to Dutch residential mortgage loans is:
    (i) 80% in Dutch covered bond programmes which are designed to be backed by CRD-compliant cover assets (ABN AMRO, ING and SNS);
    (ii) 125% in Dutch covered bond programmes which are not designed to be backed by CRD-compliant cover assets (Achmea and NIBC); and
    (iii) notwithstanding the percentages mentioned in the previous two paragraphs, 100% or a different percentage for residential mortgage loans that have the benefit of a Dutch National Mortgage Guarantee (*Nationale Hypotheek Garantie*).

To date under the Dutch covered bond programmes:

(a) the Eligibility Percentage is applied to the foreclosure value at origination; and
(b) the LTV Cut-Off Percentage is applied to the market value of the mortgaged property at the relevant time. The market value is in turn calculated at 85%–90% (this differs per programme) of the applicable foreclosure value at origination, subject to indexation. As to indexation: (i) if prices go

up, the property value is increased by 85%–100% (this differs per programme) of the increase; and (ii) if prices go down, the value is reduced by 100% of the decrease.

13.3.6. Registration by DNB

Before a Dutch covered bond qualifies for the regulatory benefits available to Regulated Covered Bonds, it needs to be registered by DNB. For that purpose the issuing bank will need to demonstrate to DNB that the bonds qualify as covered bonds within the meaning of the Regulation by submitting documents showing that the following requirements are met:

(a) the requirements set out in paragraph 13.3.4 (*Regulated Covered Bonds*) above and paragraph 13.3.7 (*Ongoing administration and reporting obligations*) (a) and (b) below[41] are met;
(b) the covered bonds must have a credit rating of at least AA- (Fitch or S&P) or Aa3 (Moody's);[42]
(c) there must be a healthy ratio between on the one hand the programme/issuance amount and on the other hand (i) the value of the cover assets; (ii) the value of the remaining assets of the issuing bank eligible and freely available for addition to the cover assets; and (iii) the consolidated balance sheet of the issuing bank (the latter to protect other stakeholders);[43] and
(d) the issuing bank must have solid and effective strategies and procedures for verifying and procuring the sufficiency of the cover assets, taking into account the composition of the cover assets, the over-collateralisation and the applicable risks and stress tests.[44]

To date the ABN AMRO, ING, NIBC and SNS covered bond programmes are registered by DNB. The register is available on-line and can be found at <www.dnb.nl/openboek/extern/id/en/all/41-194648.html> (click on: Searching in the register). The DNB register indicates whether the relevant covered bonds are registered as UCITS-compliant or UCITS- & CRD-compliant. Dutch covered bonds which are not registered are Contractual Covered Bonds and are neither UCITS-compliant nor CRD-compliant.

DNB will notify the Commission of the European Communities of each covered bond programme registered by it, for inclusion of the relevant covered bonds in the register maintained by the European Commission under section 22(4) UCITS Directive.[45]

41. Section 20a(1) FSA Implementing Regulation.
42. Section 20a(2)(a) FSA Implementing Regulation.
43. Section 20a(2)(b) FSA Implementing Regulation.
44. Section 20a(2)(c) FSA Implementing Regulation.
45. For the register maintained by the European Commission, see <http://ec.europa.eu/internal_market/investment/legal_texts/instruments_en.htm>.

13.3.7. Ongoing Administration and Reporting Obligations

Once a Dutch covered bond programme is registered by DNB, the issuing bank will have ongoing administration and reporting obligations towards DNB:

(a) it must keep a record of all covered bonds issued and of all assets serving as cover assets;[46]

(b) it must demonstrate at least quarterly[47] that the covered bonds continue to meet the criteria summarised in paragraph 13.3.4 (*Regulated Covered Bonds*) above, by granting DNB access to the records referred to in (a) above and for instance audit reports, credit rating reports[48] and reports regarding the cover assets.[49] This is without prejudice to the general authority of DNB to request information from the issuing bank on the basis of its regular banking supervision powers;[50]

(c) it must demonstrate at least annually to DNB that it complies with the requirement set out in paragraph 13.3.6 (*Registration by DNB*) under (d) above;[51]

(d) annually, within six months of the close of its financial year, it must submit to DNB the annual financial statements and the annual report of the CBC;[52]

(e) it must immediately notify DNB if, for as long as any covered bond is outstanding (i) changes occur in respect of the data, transaction documents or other submitted documents, as a result of which the outstanding covered bonds are or will no longer be compliant with the requirements for registration; or (ii) significant changes are made in the covered bond programme or the conditions of the covered bonds;[53] and

(f) before it issues any further covered bonds, (i) it must ascertain that the requirements for registration are complied with[54] (there is no need to have the further covered bonds assessed by DNB); and (ii) if the ratio between the total nominal value of the covered bonds and the consolidated balance sheet total of the issuing bank increases beyond what DNB had determined to be a healthy ratio, the issuing bank must demonstrate to DNB that the new ratio can be considered healthy.[55]

46. Section 124c(a) Decree on Prudential Rules FSA.
47. Section 124c(b) Decree on Prudential Rules FSA in conjunction with s. 20c(1)(a) FSA Implementing Regulation.
48. Section 124c(b) Decree on Prudential Rules FSA.
49. Section 20c(1)(a) FSA Implementing Regulation.
50. Section 1:74 FSA.
51. Section 20c(1)(b) FSA Implementing Regulation.
52. Section 20c(2) FSA Implementing Regulation.
53. Section 20c(3) FSA Implementing Regulation.
54. Section 20b(1) FSA Implementing Regulation.
55. Section 20b(2) FSA Implementing Regulation.

13.3.8. Deregistration

If the covered bonds no longer meet the requirements set by the Regulation or if the issuing bank no longer complies with its ongoing administration and reporting obligations towards DNB, there are likely to be short communication lines between the issuer and DNB. If it comes to sanctions, it may be that an issuance-stop is imposed on the issuing bank, which may be disclosed by DNB in its register. DNB is entitled to strike the registration of a covered bond.[56] In practice it is not very likely that DNB would ever exercise its deregistration authority. Apart from verbal assurance this is confirmed by the Decree Explanatory Notes, which in short state:

(a) that deregistration will only occur (i) after due consideration of the interests of the issuing bank and the covered bondholders; and (ii) in the exceptional circumstance that DNB's supervision is no longer in the interest of the issuing bank and no longer grants protection to covered bondholders; and
(b) that the interests of the issuer and the covered bondholders include that the registration and supervision be maintained.[57]

In the event of cancellation of the registration by DNB, DNB will notify the Commission of the European Communities without delay and publish the same on its website immediately.[58]

13.4. SOME BENEFITS OF REGULATED COVERED BONDS

13.4.1. ECB Monetary Policy Operations

As Dutch Regulated Covered Bonds are UCITS-compliant, they receive special treatment from the ECB in determining their eligibility for monetary policy operations (such as the marginal lending facility to obtain overnight liquidity from national central banks), including:

(a) they are eligible even where the bank posting the covered bonds as collateral is the issuing bank (or has 'close links' with the issuing bank or the guarantor of the covered bonds). This means for example that a Dutch bank wishing to borrow from DNB may use its own UCITS-compliant Regulated Covered Bonds as collateral (informal assurance suggests that CRD-compliance is currently not required and that 'own' Contractual Covered Bonds will not be accepted);
(b) they need not be admitted to trading on a regulated market (as defined in the Markets in Financial Instruments Directive (2004/39/EC)); and

56. Section 124b(3) Decree on Prudential Rules FSA.
57. Page 14 of the Decree Explanatory Notes.
58. Section 124b(3) Decree on Prudential Rules FSA.

(c) unlike other asset-backed securities:
  (i) they are not eligible for an exemption from the general rule that debt instruments must have a fixed, unconditional principal amount;
  (ii) they may be backed by credit linked notes or similar claims resulting from the transfer of credit risk by means of credit derivatives; and
  (iii) they are exempt from certain true sale requirements and credit quality thresholds. However, these exemptions are of lesser relevance for Dutch UCITS-compliant Regulated Covered Bonds because the Regulation requires a segregated structure as well as a credit rating of at least AA-/Aa3.

13.4.2. Regulatory

It depends on the type of investor whether investing in a certain category of Dutch Regulated Covered Bonds provides regulatory special treatment, as summarised in Table 13.2.

Table 13.2. Special Regulatory Treatment of Investments in Dutch Regulated Covered Bonds

Dutch RCB category → *Type of investor ↓*		*UCITS-compliant*	*UCITS- &* *CRD-compliant*
UCITS and insurance companies		Higher investment limit	Higher investment limit
Banks and investment firms using:	Standardised Approach	None	– Exemption from large exposure limit – Lower risk-weighting
	Foundation IRB Approach	None	– Exemption from large exposure limit – Lower loss given default value
	Advanced IRB Approach	None	Exemption from large exposure limit

This can be explained in more detail as follows:

(a) *Higher investment limits/exemption from large exposure limit*. To avoid that they have 'too many eggs in one basket' (i) banks and investment firms may not incur an exposure in excess of 25% of their own funds (*toetsingsvermogen*)[59] to a single counterparty or a group of connected counterparties; (ii) insurance companies may not invest more than 5% of their total gross technical provisions in investments[60] issued by a specific issuer or in loans to a specific borrower,[61] taken together; and (iii) UCITS may not invest more than 10% of their assets in securities issued by the same issuer.[62] However, if the investments/exposures regard Regulated Covered Bonds, the exposures of the banks and investment firms are exempted and the limits for insurance companies and UCITS are raised to 40% and 25%, respectively;[63] and

(b) *Lower risk-weighting/lower loss given default value*. Banks and investment firms are required to have sufficient (supervisory) own funds (*toetsingsvermogen*) in relation to the size of their liabilities and the nature and extent of their business risks.[64] In relation to credit risk,[65] in short, banks and investment firms are currently required to have own funds equal to at least 8% of the sum of the amount of the risk-weighted assets[66] (*naar risico gewogen activa*) and off-balance-sheet items[67] of all their business activities.[68] In calculating the amount of the risk-weighted assets, banks and investment firms can apply one of three approaches:
   (i) the Standardised Approach which is generally used by the smaller and some medium-sized banks and investment firms. Under the Standardised Approach senior unsecured exposures to issuing banks that have been assigned a credit rating of AA- (Fitch or S&P) or Aa3 (Moody's) are given a risk-weight of 20%.[69] However, if those exposures relate to Regulated Covered Bonds issued by those banks, a risk-weight of 10% applies;[70] or
   (ii) (subject to permission by DNB and depending on the level of sophistication of the relevant bank or investment firm), the Foundation

59. Section 102(1) Decree on Prudential Rules FSA.
60. As referred to in s. 122b(1)(a) under 1 and 3 Decree on Prudential Rules FSA.
61. Section 123(3) Decree on Prudential Rules FSA.
62. Section 134(1) Decree on Conduct of Business of Financial Undertakings.
63. Section 7:8(2)(g) Solvency Requirements FSA (only if an over-collateralisation applies), s. 124a Decree on Prudential Rules FSA and s. 135(1) Decree on Conduct of Business of Financial Undertakings, respectively.
64. The idea being that they are then better able to deal with unfavourable (market) developments.
65. The risk of a loss due to default of payment.
66. Including loans (either secured or not), securities (including covered bonds, RMBS, equity shares and participations) and tangible assets.
67. Including guarantees, credit derivatives, acceptances, asset sale and repurchase agreements and outright forward purchase agreements.
68. Section 60(1)(a) Decree on Prudential Rules FSA.
69. Section 2.2.6 of the Solvency Requirements FSA.
70. Section 2:40(a) Solvency Requirements FSA. Under s. 2:39(b) Solvency Requirements FSA covered bonds meeting the definition of s. 22(4) UCITS Directive (i.e., UCITS-compliant Regulated Covered Bonds) and issued before 31 Dec. 2007 are also eligible for the preferential treatment until their maturity.

Internal Ratings Based (IRB) Approach or the Advanced IRB Approach. Under the Foundation IRB Approach and the Advanced IRB Approach the amount of the risk-weighted assets may be calculated by using own internal estimates of the probability of default (PD).[71] However in respect of exposures to banks the loss given default (LGD) value, which is one of the other input parameters for this calculation, is a given amount if the Foundation IRB Approach is used. Whereas for example a senior exposure without eligible collateral is assigned an LGD value of 0.45, Regulated Covered Bonds (covered by specified assets) are assigned an LGD value of 0.1125.[72]

A further regulatory special treatment which is not reflected in the above diagram, is available to CRD-compliant Regulated Covered Bonds in the context of banks and investment firms entering into repurchase transactions (repo's) with the issuing bank. If the issuing bank posts its own covered bonds as collateral under the repo, then such covered bonds only qualify as financial collateral under the Solvency Requirements FSA for the purpose of mitigating the credit risk of the bank/investment firm on the issuing bank as its repo counterparty if such covered bonds are CRD-compliant.[73]

71. Section 69 of the Decree on Prudential Rules FSA.
72. Under the grandfathering provision in s. 8:2 Solvency Requirements FSA this waiver is given in respect of the default LGD value of 0.125 provided in s. 3:44(1)(c) Solvency Requirements FSA until 31 Dec. 2010.
73. Section 4:29(2) Solvency Requirements FSA.