**High level summary Dutch legislative framework for regulated covered bonds**

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**1. Legislation**

The Dutch legislative framework for regulated covered bonds is incorporated in:

* the Dutch Financial Supervision Act (*Wet op het financieel toezicht*);
* the Decree on Prudential Rules Wft (*Besluit prudentiële regels Wft*); and
* the Implementing Regulation Wft (*Uitvoeringsregeling Wft*) (together the 'Legislation').

The Legislation replaces the Dutch covered bond regulations introduced in 2008 (the '2008 Regulations').

The aim of the Legislation is to strengthen regulatory supervision on regulated covered bonds by the Dutch Central Bank (*De Nederlandsche Bank* ('DNB')), to increase investor confidence and to lower financing costs of Dutch banks.

The Legislation incorporates new (international) market standards, including the best practices identified by the European Banking Authority (EBA) in its report "EBA Report on EU Covered Bond Frameworks and Capital Treatment" of 1 July 2014, and certain contractual and structural features of existing Dutch covered bond programs. Although the Legislation contains a number of additional registration requirements focusing on, amongst other things, transparency, cover asset quantity and quality and stress testing, the Legislation does not substantially amend the requirements under the 2008 Regulations relating to asset segregation, risk management, asset encumbrance safeguards and reporting to DNB.

The Legislation prescribes a so-called "segregated" structure, being a structure where the cover assets are segregated from the issuer and owned by a special purpose company (the 'CBC'), which is separate from, and not affiliated to, the issuer. Asset segregation takes place on the basis of the Dutch Civil Code and the Dutch Bankruptcy Code (or foreign equivalent).

*Segregated Structure Dutch Covered Bonds*

**Issuing bank**

Transfer of assets Covered Bonds

Guarantee

**Investors**

**CBC**

The Legislation only relates to the issuance of covered bonds by Dutch banks. Dutch rules pertaining to investment in covered bonds by Dutch regulated entities are contained in other regulations, directives and rules.

**2. Regulated Covered Bonds**

A Dutch covered bond registered under the Legislation by DNB will comply with the conditions for preferential treatment as set out in article 52.4 of the UCITS Directive and, provided that the relevant requirements of the Legislation continue to be met for so long as such covered bond is outstanding, article 129 of the Capital Requirements Regulation (CRR) ('Regulated Covered Bonds'). A Regulated Covered Bond is therefore eligible for receiving favourable treatment under the monetary policy operations of the European Central Bank. DNB will record in its covered bonds register whether the relevant category of covered bonds (continues to) comply with article 129 CRR. Under the 2008 Regulations, compliance with article 129 CRR is optional.

The register is available online and can be found at: [www.dnb.nl/en/supervision/consumer-and-supervision/registers/WFTGO](http://www.dnb.nl/en/supervision/consumer-and-supervision/registers/WFTGO).

In respect of an application made for registration of a covered bond (and the issuer thereof) pursuant to the Legislation the following requirements must be met:

* the issuer is a bank having its registered office in the Netherlands. That excludes non-bank subsidiaries and banks operating in the Netherlands on a cross-border basis or through a branch office;
* the cover assets provide sufficient cover for the payment of principal and interest on the covered bonds and costs relating to risk management and management and administration of the cover assets and covered bonds;
* the cover assets have been safeguarded for the benefit of the covered bondholders by way of a transfer to a CBC;
* the issuer or its group do not own or control the CBC and the CBC must be a remote special purpose vehicle specifically set up for one category of covered bonds (i.e. one programme or transaction);
* disclosure by the issuer to DNB of certain key conditions applicable to the relevant category of covered bonds, which include:
  + whether the covered bond has one of the following maturity structures: (i) its maturity date cannot be extended (hard bullet maturity) or can only be extended for a maximum of 24 months (soft bullet maturity) or (ii) its maturity date can be extended with more than 24 months (including (conditional) pass through);
  + which type or types of cover assets can unlimitedly be included in the cover pool (primary cover assets) and if more than one type is included, the ratio between them; and
  + the jurisdiction in which the debtors of the cover assets are located or resided and the governing law of the cover assets.
* the issuer must ensure that a healthy ratio exists between the total amount of outstanding covered bonds of the relevant category and the total consolidated balance sheet of the issuer; and
* the issuer must have reliable and effective strategies and procedures for verifying and procuring the sufficiency of eligible cover assets and liquid assets, taking into account the composition of the cover assets, the statutory over-collateralisation, other asset cover requirements and liquidity buffer requirements.

A minimum credit rating for Regulated Covered Bonds as required under the 2008 Regulations is no longer required under the Legislation.

**3. Eligible cover assets**

Primary cover assets

Currently, under the Legislation the following assets can be used as primary cover assets for the cover pool of a Regulated Covered Bond:

* public sector (guaranteed) exposures as referred to in article 129 CRR, paragraph 1(a) and (b) (excluding credit quality step 2 exposures);
* residential mortgage loans or guaranteed residential loans as referred to in article 129 CRR, paragraph 1(d)(i) and (e) respectively;
* commercial mortgage loans as referred to in article 129 CRR, paragraph 1(f)(i); or
* shipping loans as referred to in article 129 CRR, paragraph 1(g).

An issuing bank may use only one category of cover assets as primary cover assets, save for residential mortgage loans and commercial mortgage loans, which can be combined as primary cover assets, provided that the ratio between these categories is fixed as from the date of registration.

Substitution assets

The Legislation permits the inclusion of substitution assets in the relevant cover pool provided that the substitution assets do not exceed 20% of the nominal amount of the outstanding Regulated Covered Bonds. Substitution assets must either be public sector (guaranteed) exposures as referred to in article 129 CRR, paragraph 1(a) or (b), exposures to institutions as referred to in article 129 CRR, paragraph 1(c) or credit quality step 2 exposures permitted by DNB as referred to in article 129 CRR, paragraph 1, third sub-paragraph, and are further subject to the restrictions of article 129 CRR.

**4. Asset cover tests**

All Dutch covered bond programmes to date contain contractual asset cover tests which: a.) must ensure that assets transferred to the CBC will be sufficient to make all interest and principal payments on the covered bonds in case of a default by the issuer and b.) are required to maintain the relevant credit ratings assigned to the covered bonds. The Legislation in addition contains two mandatory asset cover tests and a liquidity test which are (to be) included in each Dutch regulated covered bond programme.

Mandatory asset cover tests and over-collateralisation

The Legislation contains two mandatory asset cover tests. Firstly, the total value of the cover assets must be at least 105% of the nominal value of the outstanding Regulated Covered Bonds. In addition to this minimum over-collateralisation requirement, the total value of the cover assets, so determined in accordance with the restrictions applicable to the relevant type of assets as set out in article 129 CRR, paragraph 1 (see paragraph 5 (*Loan-to-value ratio*)), should at least be equal to the nominal value of the outstanding Regulated Covered Bonds. With respect to primary cover assets, their nominal value will be taken into account and for substitution assets their market value as determined in accordance with internationally accepted accounting principles.

Defaulted cover assets as referred to in article 178 CRR, cover assets in respect of which third parties are entitled to (part) of the proceeds thereof (for example, sub-participations), and cover assets which represent exposures to the relevant issuing bank or its group companies must be deducted when determining the value of the cover assets.

Mandatory liquidity buffer

The Legislation requires the CBC to have (or generate) sufficient liquid assets to cover in the following six month period the payment of: a.) interest, b.) principal (only in respect of Regulated Covered Bonds which have an extension of less than six months) and c.) other permitted amounts that are equal or higher ranked (eg. administrative costs).

For the purpose of calculating the mandatory liquidity buffer, the CBC must also take into account expected cash flows from derivatives and other risk mitigating contracts relating to such payment obligations. Liquid assets may consist of the same type of assets which are permitted as substitution assets (see above).

**5. Loan-to-value ratio**

The CRR prescribes that covered bonds may be backed by residential mortgage loans only up to the lesser of:

* the principal amount of the relevant mortgage right; and
* 80% of the value of the underlying mortgaged property.

However, Dutch residential mortgage loans may in practice have a loan-to-foreclosure value ('LTFV') ratio of up to 125% and as from august 2011, a loan-to-market value ('LTMV') ratio of up to 104%. To date all Dutch covered bond programmes take a two-step approach towards LTFV and LTMV ratios of Dutch residential mortgage loans:

* subject to certain exceptions in some programmes, a loan is only eligible to be transferred to the CBC if- at origination – the LTFV-ratio does not exceed 125% for loans originated prior to august 2011, and for loans originated thereafter when the LTMV-ratio does not exceed 104% (the 'Eligibility Percentage'); and
* 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 (the 'LTV Cut-Off Percentage') of the value of the underlying mortgaged property at such time. For example, if:
  + the relevant LTV Cut-Off Percentage is 80%; and
  + a loan has a principal amount of 110 and is backed by mortgaged property with a value of 100, then on an aggregate basis 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.

Like the CRR, the Legislation does not prescribe whether the foreclosure value or the market value of the underlying mortgaged property should be taken into account when calculating the LTV ratio. To date under the Dutch covered bond programmes:

* the Eligibility Percentage is applied to either the foreclosure value at origination or the market value depending on the date of origination; and
* the LTV Cut-Off Percentage is applied to the market value of the mortgaged property at the relevant time. The way in which the market value is determined differs per programme.

**6. Ongoing administration, reporting and audit obligations**

Once a Dutch covered bond programme is registered by DNB, the issuer will have ongoing administration and reporting obligations towards investors and DNB. It will be required to provide investors with information on a quarterly basis, including – but not limited to – information on:

* credit risks, market risks, exchange rate risk and liquidity risks;
* nominal value and maturity of the Regulated Covered Bonds issued;
* the value and composition of the underlying cover assets and liquid assets; and
* the actual percentage of over-collateralisation and size of the liquidity buffer; and
* the percentage of defaulted cover assets.

The issuer will have ongoing administration and reporting obligations towards DNB, including that it must:

* demonstrate at least quarterly that the Regulated Covered Bonds continue to meet the criteria summarised in paragraphs 2 (*Regulated Covered Bonds*), 3 (*Eligible cover* assets) and 4 (*Asset cover tests*);
* demonstrate at least annually to DNB that it has reliable and effective strategies and procedures in place for verifying and procuring the sufficiency of eligible cover assets and liquid assets;
* submit to DNB annually, within six months of the close of its financial year, the annual financial statements and the annual report of the CBC;
* submit to DNB at least annually, information on the required healthy ratio as referred to in paragraph 2 (*Regulated Covered Bonds*);
* notify DNB of significant changes it intends to make in the conditions of the Regulated Covered Bonds prior to implementation thereof; and
* provide DNB with all information with respect to the Regulated Covered Bonds DNB deems relevant to be able to exercise its supervision.

The issuer must furthermore:

* ensure on a continuing basis that the conditions applicable to the Regulated Covered Bonds contain no impediments to an effective supervision of DNB;
* carry out on a regular basis stress test to ensure that in times of financial stress the required healthy ratio referred to in paragraph 2 (*Regulated Covered Bonds*) is maintained;
* ensure that an external accountant is appointed which is required to perform at least annually an audit on the cover assets to verify whether the calculations for the abovementioned asset cover tests and mandatory liquidity buffer have been made correctly (the agreement between the account and the issuing banks must be such that the accountant will continue to perform these services post default of the issuing bank);
* ensure that in a pre-issuer default scenario, an external accountant shall at least annually perform an audit on a sample of cover assets focusing on the recorded valuation of such cover assets and the administration thereof; and
* submit to DNB copies of reports of auditors in relation to the abovementioned audits.

The above is without prejudice to the general authority of DNB to request information from the issuer on the basis of its regular banking supervision powers.

**7. No deregistration of Regulated Covered Bonds**

If Regulated Covered Bonds no longer meet the requirements set by the Legislation and 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 and DNB can impose penalties and fines. Contrary to its powers under the 2008 Regulations, DNB is however not entitled to cancel the registration of a Regulated Covered Bond. DNB is only entitled to cancel the registration of the issuing bank. In case the Regulated Covered Bonds are no longer collateralised by assets that comply with the requirements set out in article 129 CRR, DNB may delete the registration of compliance with article 129 CRR resulting in a situation where such Regulated Covered Bonds will be solely UCITS compliant.

**8. Grandfathering**

The Legislation grants issuers of registered covered bonds, and issuers that have applied for registration under the 2008 Regulations, a transitional period of twelve months from 1 January 2015 for its covered bonds to comply with the new requirements prescribed by the Legislation. Such issuers must during such transitional period comply with the requirements prescribed by the 2008 Regulations. As from 1 January 2016 the Legislation applies to all registered Dutch covered bond issuers and their covered bond programmes.

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