Single Rulebook Q&A

Question ID	2020_5522
Status	Final Q&A
Legal act	Regulation (EU) No 575/2013 (CRR)
Topic	Credit risk
Article	161
Paragraph	1
Subparagraph	d
COM Delegated or Implementing Acts/RTS/ITS/GLs/Recommendations	Not applicable
Article/Paragraph	Not applicable
Date of submission	30/09/2020
Published as Final Q&A	17/12/2021
Disclose name of institution / entity	No
Type of submitter	Credit institution
Subject matter	Treatment of third country covered bonds under IRB Approach
Question	Which LGD should be applied for third country covered bonds (issued under a dedicated legal framework) which are not eligible for the same LGD as UCITS 52(4)?
Background on the question	Article 161(1)(d) ensures a lower LGD for covered bonds compliant with Article 129 (4) or (5) CRR, which refers to UCITS Article 52(4). Under the standard approach, third country covered bonds don't qualify for lower risk weights according to Article 129 and are accordingly treated as senior exposure. Article 161 doesn't seem to allow for such choice.
Final answer	Regulation EU No 575/2013 (CRR) foresees in Article 161(1)(d) a LGD value of 11.25% for covered bonds that are eligible for the treatment set out in Article 129(4) or (5). Until 8 July 2022, to be eligible for such preferential treatment, bonds as referred to in Article 52(4) of Directive 2009/65/EC shall meet the requirements indicated in Article 129(1) and (7). In this respect, Article 52(4)

	of Directive 2009/65/EC refers to covered 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. Therefore third-country covered bonds are not eligible for the treatment in Article 161(1)(d) CRR. Thus, bonds that do not meet the criteria and requirements for eligible covered bonds according to Article 129(1) and (7) CRR, in conjunction with Article 52(4) of Directive 2009/65/EC, shall not use the LGD value pursuant to Article 161(1)(d), but shall receive a LGD in accordance with Article 161(1)(a) in the case of senior exposures without eligible collateral or with Article 161(1)(b) in the case of subordinated exposures without eligible collateral. From 8 July 2022, to be eligible for such preferential treatment, Article 129(1) CRR as amended by Regulation EU 2019/2160 requires bonds as referred to in point (1) of Article 3 of Directive (EU) 2019/2162 to meet the requirements indicated in Article 129(3), (3a) and (3b) and to be collateralised by any of the eligible assets referred to in that paragraph. In this respect, Article 3(1) of Directive (EU) 2019/2162 refers to covered bonds issued by a credit institution in accordance with the provisions of national law transposing the mandatory requirements of that Directive and that are secured by cover assets to which covered bond investors have direct recourse as preferred creditors. Article 31(1) of the Directive further requires the Commission to submit a report by 8 July 2024, together with a legislative proposal, if appropriate, on whether and, if so, how an equivalence regime could be introduced for third-country credit institutions issuing covered bonds and for investors in those covered bonds. Thus, as long as an equivalence regime has not been introduced, bonds that do not meet the criteria and requirements for eligible covered bonds according to Article 129(3), (3a) and (3b), in conjunction with Article 3 of Directive (EU) 2019/2162, should not use the LGD value pursuing Article 161(1)(d) CRR, but should receive a LGD in accordance with Article 161(1)(a) CRR in the case of senior exposures without eligible collateral or with Article 161(1)(b) CRR in the case of subordinated exposures without eligible collateral.
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European Banking Authority, 20/05/2022
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