

# Finansinspektionen's Regulatory Code

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## Finansinspektionen's regulations and guidelines regarding covered bonds;

**FFFS 2013:1**

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decided on 15 January 2013.

Finansinspektionen prescribes the following pursuant to Chapter 5, section 2, point 4 of the Banking and Financing Business Ordinance (2004:329) and section 1 of the Covered Bond (Issuance) Ordinance (2004:332).

Finansinspektionen provides general guidelines following each section of the regulations.

### Chapter 1 Scope and definitions

#### Scope

**Section 1** These regulations and general guidelines apply to banks and credit market undertakings that, in accordance with the Covered Bond (Issuance) Act (2003:1223),

- are applying for authorisation to issue covered bonds,
- have received authorisation to issue covered bonds.

The regulations contain provisions regarding

- application for authorisation to issue covered bonds (Chapter 2),
- cover pool requirements (Chapter 3),
- terms and conditions for derivative agreements and calculation of and terms and conditions for risk exposure and interest payments (Chapter 4),
- the register (Chapter 5), and
- the independent inspector (Chapter 6).

#### Definitions

**Section 2** In these regulations and general guidelines, the terms and expressions have the same meaning as in Chapter 1, section 2 of the Covered Bonds (Issuance) Act (2003:1223).

### Chapter 2 Application for authorisation to issue covered bonds

**Section 1** An undertaking applying for authorisation to issue covered bonds shall submit to Finansinspektionen

1. a copy of the minutes from the Board of Directors stating that the undertaking has decided to apply for authorisation,
2. a description of the planned operations that shows how the undertaking will manage covered bonds, the cover pool and the separate account as set out in Chapter 3, section 9, fourth paragraph of the Covered Bonds (Issuance) Act (2003:1223),
3. where appropriate, a separate plan in accordance with that set out in Chapter 2, section 1, first paragraph, point 3 of the Covered Bonds (Issuance) Act, or a description of how the undertaking plans a conversion,
4. a financial plan in accordance with Chapter 2, section 1, first paragraph, point 4 of the Covered Bonds (Issuance) Act for the upcoming three financial years that are prepared in line with the forecasts the undertaking made during its internal capital adequacy assessment process.
5. a description of how the covered bonds operations will be organised in order for the undertaking to achieve good internal control,
6. information about the IT systems that the undertaking intends to use in the planned operations.

### **Chapter 3 Cover pool requirements**

**Section 1** Provisions regarding which portion of a mortgage loan may be included in the cover pool are set out in Chapter 3, section 3 of the Covered Bonds (Issuance) Act (2003:1223). An issuing institution shall establish the primary intended purpose of the mortgage property when applying the regulation.

#### *General guidelines*

The issuing institution, when determining the primary intended purpose of the mortgage property, should obtain guidance from the land register's type codes for taxation information. If the type codes are not updated or for other reasons do not accurately depict the property's area of use, the institution may establish more correct grounds for its assessment in collaboration with Finansinspektionen.

Where a property covers several assessment units, the institution may determine the primary use with the assistance of sub-values in the tax assessment value.

The institution should also apply these general guidelines to foreign mortgage properties. In these cases the assessment should be documented.

**Section 2** Where a loan receivable that is included in the cover pool has been unsettled for 60 days or more, the issuing institution may not include its value in the cover pool when making assessments in accordance with Chapter 3, sections 8 and 9 of the Covered Bonds (Issuance) Act (2003:1223).

### **How to conduct a valuation when a loan is granted**

**Section 3** The appraiser who shall carry out an individual valuation in accordance with Chapter 3, section 5 of the Covered Bonds (Issuance) Act (2003:1223) shall possess sufficient theoretical and practical experience regarding the manner in which the valuation shall be carried out and otherwise be knowledgeable about the general and local property market.

**Section 4** An issuing institution shall ensure that recognised and accepted valuation methods are used during the valuation.

#### *General guidelines*

The issuing institution should document the basis of valuations that are based on general price levels.

### **How verification of the market value shall be carried out**

**Section 5** Provisions stating that an issuing institution shall verify on a regular basis the market value of property that forms collateral for mortgage loans are set out in Chapter 3, section 7 of the Covered Bonds (Issuance) Act (2003:1223).

If the price levels of comparable properties fall, the institution shall verify that the property that forms collateral for mortgage loans has the same value as in the original or most recent valuation. Where the market conditions for comparable properties at the locality or in the region have seriously declined, the valuation shall be re-assessed.

The institution shall verify in particular the prices in the regions or within the categories where the fall in prices, or the risk that prices will fall, is the largest.

#### *General guidelines*

The issuing institution may choose to re-assess valuations of collateral in the register above and beyond that set out in section 5. If the institution chooses to register appreciations in value, it should correspondingly register depreciations in value. Index-based appreciation, where appropriate, should only be used for property, site-leasehold rights and tenant-owner rights that are intended for residential purposes. For other collateral, the institution should only raise the value after an individual valuation corresponding to that set out in Chapter 3, section 5 of the Covered Bonds (Issuance) Act. The institution should document at least once a year the positions that affect revaluations.

### **Sensitivity analysis**

**Section 6** An issuing institution shall test and analyse how future changes in market values may affect the loan-to-value ratios and the value of the cover pool. The institution shall regularly and at least once a year conduct tests of all property that forms collateral for mortgage loans in the cover pool. The tests shall be appropriate and based on conservative assumptions.

The tests shall include the effect a fall in prices of at least 5, 10, 15, 20, 25 and 30 per cent has on the loan-to-value ratios, value of the cover pool and matching requirements.

The report on such a sensitivity analysis shall include measures that show how the institution can improve matching in the event prices fall.

The institution shall submit the report to the independent inspector.

## **Chapter 4 Terms and conditions for derivative agreements and calculation of, and terms and conditions for, risk exposure and interest payments**

### **Matching rules**

**Section 1** Provisions regarding matching of the cover pool to the value of claims against an issuing institution due to covered bonds are set out in Chapter 3, section 8 of the Covered Bonds (Issuance) Act (2003:1223).

#### *General guidelines*

When calculating the matching in accordance with Chapter 3, section 8 of the Covered Bonds (Issuance) Act (2003:1223) the issuing institution should take into consideration any foreign exchange rate differences and the book value of any derivative agreements.

### **Calculation of present value**

**Section 2** Provisions regarding the calculation of the present value of assets and liabilities in the cover pool are set out in Chapter 3, section 9 of the Covered Bonds (Issuance) Act (2003:1223).

The present value of the assets in the cover pool, during a daily calculation, shall exceed the present value of the liabilities which relate to the covered bonds. The present value of derivative agreements shall also be included in the calculation. The interest rate curve for discounting future cash flows (discount interest rate curve) that is used shall be derived from the swap rate curve for each currency.

### **Interest rate risk**

**Section 3** The requirement set out in section 2 shall also be fulfilled after a parallel shift to the swap rate curve by one percentage point in an unfavourable direction.

#### *General guidelines*

In addition to the present value calculations, an issuing institution should also regularly perform other calculations relevant for the institution which are based on assumed interest rate changes. The institution, for example, may make assumptions of twists in the swap rate curve in such calculations.

## Currency risks

**Section 4** Where an issuing institution's cover pool includes assets that are denominated in a different currency than the covered bonds, the institution, if the currency risk is not fully hedged, shall fulfil the following conditions:

- During a daily calculation, the present value of the issuing institution's cover pool shall exceed the present value of the liabilities which relate to the covered bonds in the event of a ten-per cent change in the ratio between the currency of the bonds and the currency of the assets in an unfavourable direction.
- The present value of derivative agreements shall also be included in the calculation.

**Section 5** An issuing institution shall document and save the results of the daily calculations of the present values, interest rate risk and currency risk in a secure manner for at least five years.

## Terms and conditions for derivative agreements and the separate account

**Section 6** A derivative agreement that an issuing institution has chosen to enter into for its risk management in accordance with the matching rules in Chapter 3, sections 8 and 9 of the Covered Bonds (Issuance) Act (2003:1223) may only refer to covered bonds and assets in the cover pool.

**Section 7** A derivative agreement may not be designed such that it is terminated at the counterparty's request or automatically terminates if the issuing institution enters into bankruptcy.

**Section 8** An issuing institution may only enter into derivative agreements with a counterparty that at the time the agreement is entered into has a publicly recognised credit rating from a qualified rating institution at a level not less than that set forth in the table below.

Credit rating institution	Lowest credit rating
	<i>Long term</i>
Moody's	A3
Standard & Poor's	A-
Fitch	A-

If a counterparty has a credit rating from a credit rating institution that does not fulfil the minimum requirements set out in the above table, the derivative agreement may only be entered into if the counterparty fulfils the requirements regarding credit ratings from the other two credit rating institutions.

If any of the credit rating institutions listed in the table change the designation of their assessment scales, the requirement for the lowest credit rating shall be correspondingly adjusted.

**Section 9** An issuing institution shall immediately inform Finansinspektionen and the independent inspector if a counterparty's credit rating is downgraded below the level set out in section 8. No new derivative agreements may be entered into with this counterparty without Finansinspektionen's approval. The issuing institution shall prepare within 90 calendar days a report describing which outstanding derivative agreements the institution has entered into with the counterparty and a

plan for how the institution intends to handle the outstanding derivative agreements.

**Section 10** Derivative agreements with counterparties that do not fulfil the requirements set out in sections 6–8 may be approved by Finansinspektionen where special grounds exist.

### **The separate account**

**Section 11** Provisions stating that an issuing institution's funds from certain payment flows shall be kept apart from its other funds in a separate account are set out in Chapter 3, section 9, fourth paragraph of the Covered Bonds (Issuance) Act (2003:1223).

#### *General guidelines*

It should also be possible to separate these funds in the day-to-day accounting.

The issuing institution should ensure that it has an organisation and IT systems that fulfil the requirements for the separate account if the institution enters into bankruptcy.

## **Chapter 5 Register**

### **Security requirements**

**Section 1** The register referred to in Chapter 3, section 10 of the Covered Bonds (Issuance) Act (2003:1223) shall be stored in a secure and transparent manner.

### **How to maintain the register**

**Section 2** The information which in accordance with Chapter 3, section 11 of the Covered Bonds (Issuance) Act shall be included in the register and that refers to covered bonds and derivative agreements shall be entered into the register no later than the agreement date. Information which shall be included in the register and that relates to loans and substitute collateral shall be entered into the register on the day from which the relevant loan or substitute collateral is included in the cover pool. Thereafter, information relating to repayment instalments, current interest rates and terms and condition periods shall be updated on a daily basis.

**Section 3** If, at the time the loan is granted, a mortgage loan exceeds the loan-to-value limits set out in Chapter 3, section 3 of the Covered Bonds (Issuance) Act (2003:1223), information about the amount by which the loan may be applied to the cover pool shall be entered into the register.

**Section 4** If the market value of an asset that is collateral for a mortgage loan has changed so that a new value must be determined in accordance with Chapter 3, section 7 of the Covered Bonds (Issuance) Act (2003:1223) the new value shall be entered into the register as soon as possible.

**Section 5** An issuing institution shall maintain separate registers of bonds that are issued with rights of priority in different cover pools. The matching requirements

set out in Chapter 3, sections 8 and 9 of the Covered Bonds (Issuance) Act (2003:1223) shall be fulfilled for assets and liabilities in each register.

### **Accessibility**

**Section 6** An issuing institution shall ensure that Finansinspektionen and the independent inspector can access the register at all times.

## **Chapter 6 The independent inspector**

### **Independence requirement**

**Section 1** An independent inspector in accordance with the Covered Bonds (Issuance) Act (2003:1223) may not have other assignments in the issuing institution or in other firms within the group to which the institution belongs. The independent inspector, in the event the institution's external audit is conducted by auditors from the same firm as the inspector, shall be able to demonstrate to Finansinspektionen that there are no conflicts of interest between the independent inspection and the external audit.

### **The inspector's duties**

**Section 2** The independent inspector shall monitor that the register in accordance with Chapter 3, section 10 of the Covered Bonds (Issuance) Act (2003:1223) is properly maintained and shall in particular monitor that

1. bonds and derivative agreements are registered in accordance with Chapter 3, section 11 of the Covered Bonds (Issuance) Act,
2. only loans and substitute collateral which fulfil the qualification requirements are added to the cover pool and that they are accurately registered,
3. the valuations of the underlying collateral are in accordance with the provisions of the law and these regulations with regard to the manner in which a valuation shall be carried out,
4. mortgage loans whose underlying collateral has diminished significantly in value in connection with the matching are only included in the cover pool at an amount which is within the new reduced loan limitations, and that
5. the matching rules are complied with.

**Section 3** The independent inspector shall review the revaluations of underlying collateral that the issuing institution conducted during the year.

**Section 4** The independent inspection shall be risk-based. The inspection of the value of the collateral, for example, shall focus on the geographic areas and types of collateral where the risk that the price may fall is judged to be particularly large and where the fall in prices has been largest. IT and system risks shall be reviewed more carefully after serious incidents or major system updates.

### **Reporting obligations**

**Section 5** The independent inspector, before he or she carries out the annual inspection, shall submit an inspection plan to Finansinspektionen.

**Section 6** The independent inspector shall submit a report about the inspection to Finansinspektionen once a year. Finansinspektionen shall have received the report no later than 60 calendar days after the end of the calendar year.

**Section 7** The annual report in accordance with section 6 shall contain as a minimum

1. an overall report of the manner in which the inspection work has been organised and performed;
2. a report of observations made with respect to the issuing institution's business regarding covered bonds,
3. a report of the revaluations of underlying collateral that were conducted by the institution, and
4. a report of the institution's sensitivity analyses of property that is collateral for mortgage loans in the register in accordance with Chapter 3, section 6.

**Section 8** The independent inspector, in addition to that set out in section 6, shall inform Finansinspektionen as soon as he or she becomes aware of conditions that refer to the issuing institution's covered bonds and that may be of significance for the authority in its supervision of the institution.

**Section 9** The independent inspector shall submit information to Finansinspektionen every year about the number of hours he or she spent on the inspection and the break-down of principal tasks and fees charged.

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These regulations and general guidelines shall enter into force on 1 July 2013, whereupon Finansinspektionen's regulations and general guidelines (FFFS 2004:11) regarding covered bonds shall be repealed.

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