

### **3.3 BELGIUM**

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#### **I. FRAMEWORK**

Belgium is currently one of the few European countries that has no dedicated legal framework in place. However it should not take too long anymore before Belgian credit institutions can use covered bonds as an alternative funding tool knowing that the covered bond fundamentals are laid down in a draft legislation. This draft proposal, whereby the National Bank of Belgium (NBB) set pen to paper, is the result of ongoing discussions since 2009 between the Belgian banking sector, the NBB, the Belgian regulator (FSMA) and some law firms<sup>2</sup>. It is expected that Belgium will join the dedicated legal framework countries by the end of 2011.

The description of the forthcoming Belgian covered bond framework in the following sections is based on the draft legislation as it currently stands but might still be subject to changes going forward.

The legal basis for Belgian covered bonds will be incorporated into the Act of 22 March 1993 on the status and the supervision of credit institutions. This will be supplemented by a Royal Decree and several regulations.

#### **II. STRUCTURE OF THE ISSUER**

Belgian covered bonds can be issued by universal credit institutions<sup>3</sup> established in Belgium. However such institutions will first need to be licensed by the NBB as covered bond issuer and also the covered bond program itself will need to get approval from the NBB. For both licenses, an extensive file detailing several aspects (f.ex. strategy, solvability, risk management, etc) needs to be submitted. A license can be obtained but it might be conditional upon respecting issuance limits that the NBB on a case-by-case basis might decide on. If licensed, the issuer and the program(s) will be added to specific lists that will be available for consultation on NBB's website. At program level a further distinction is made between CRD-compliant covered bonds, i.e. "Belgian pandbrieven/lettres de gage", and non CRD-compliant covered bonds, i.e. "Belgian covered bonds". The denomination of both terms is protected by law. These distinct types of covered bonds will appear on two separate lists. However the way that the law and the Royal Decree are stipulated, makes that in practice the Belgian credit institutions will only be able to issue CRD-compliant covered bonds. Therefore in what follows we will only concentrate on the Belgian pandbrieven.

Consultation of the NBB's website will hence give an overview of:

- > Belgian credit institutions issuing covered bonds
- > Belgian pandbrieven programs and its specific issuances

When a credit institution issues Belgian pandbrieven, its assets will by operation of law consist of two distinct estates: its general estate on the one hand and a separate, ringfenced "segregated estate" ("patrimoine special") on the other hand. The general estate will comprise those assets of the issuing bank to which all its creditors have a direct recourse.

1 Special thanks to my Dexia colleagues and the colleagues of Stibbe & BNP Paribas Fortis for reviewing the text!

2 Allen & Overy (Brussels), Stibbe (Brussels)

3 Existing credit institutions could decide to issue themselves or to issue from a newly created credit institution. The latter would be a subsidiary or an affiliate of the mother company.

The Belgian pandbrieven investors will have a direct recourse to (i) the general estate of the issuing credit institution (i.e. repayment of the Belgian pandbrieven is an obligation of the issuing bank as a whole) and (ii) the segregated estate, that will comprise the cover pool that is exclusively reserved for the Belgian pandbrieven investors of a specific program and for the claims of other parties specifically related to that program. Assets will become part of the cover pool upon registration in a register held by the issuer for that purpose. As of that moment those assets will form part of the segregated estate.

When insolvency proceedings are opened, by operation of law, the assets recorded in the segregated legal estate do not form part of the insolvent general estate and hence will not be affected by the opening of the insolvency proceedings. Belgian pandbrieven investors will upon insolvency of the credit institution fall back on the cover pool assets for the timely payment of their bonds but at the same time holders will continue to have a claim against the insolvent general estate. Creditors that are not related to the segregated estate will not have any recourse to these cover pool assets. Only following repayment of all Belgian pandbrieven will any amounts left in the special estate return to the insolvent general estate.

### **III. COVER ASSETS**

All assets and instruments that will be legally segregated for the benefit of the Belgian pandbrieven investor in a separate estate constitute the cover pool. The cover pool can be composed of assets that are part of any of the following categories:

- > category 1: residential mortgage loans, and/or senior RMBS
- > category 2: commercial mortgage loans, and/or senior CMBS
- > category 3: exposure to the public sector, and/or senior public sector ABS
- > category 4: risk on financial institutions
- > category 5: derivatives

These five general categories are subject to further eligibility criteria:

- > geographical scope: OECD, except for category 1 and 2 that are further restricted to EEA;
- > with respect to the MBS/ABS as mentioned in each of the first three categories: ABS/MBS are eligible provided that 90% of the underlying pool is directly eligible and is originated by a group related entity of the issuer of the Belgian pandbrieven. The ABS/MBS qualify for credit quality step 1 (as set out in annex IX, part 4, 6 of the 2006/48/CE Directive). The securitization vehicle of the ABS/MBS must be located in the EU;
- > for the mortgage loans mentioned in category 1 and 2: the loans need to be guaranteed by first lien (and subsequent lower ranking) mortgages on (residential or commercial) properties located in the EEA. Mortgage loans with properties under construction/in development can only be added to the cover pool if they do not represent more than 15% of all the mortgage loans taken up in the cover pool;
- > for category 3: exposure to the public sector can only be (i) exposure to or guaranteed or insured by central governments, central banks, public sector entities, regional governments and local authorities or (ii) exposure to or guaranteed or insured by multilateral development banks or international organizations that qualify as a minimum for a 0% risk weighting as set out in annex VI, 20 of the 2006/48/CE Directive;

- > for category 5: derivatives, of which the counterparty has a low default risk (to be further determined by NBB what can be understood by this), are only eligible if related to cover the interest rate/currency risk of the cover assets or Belgian pandbrieven. Moreover, a group related entity of the Belgian pandbrieven issuer is not eligible as derivative counterparty unless (i) it is a credit institution that benefits from a credit quality step 1 (as defined in Annex VI, points 29 to 32 of the 2006/48/CE Directive) and forms part of the EEA, and (ii) it has a (unilateral) credit support annex (CSA) in place. Note that any assets posted under the CSA would belong to the separate legal estate, but are not considered as a cover asset as described in this section III. Finally, the derivative contract needs to stipulate that suspension of payments or bankruptcy of the issuer does not constitute an event of default;
- > for all of the categories: assets that are in default (>90days delinquent) may not be added to the cover pool.

The cover pool can be composed of assets out of each of the five categories. But per program that is set up, assets out of one of the first three categories (so either residential mortgage loans, commercial mortgage loans or exposure to public sector) need to represent a value of at least 85% of the nominal amount of Belgian pandbrieven. In practice this comes down to three types of Belgian pandbrieven programs that can be set up: residential mortgage covered bond program, commercial mortgage covered bond program or public covered bond program. How such value is determined, is explained in the following chapter.

#### **IV. VALUATION AND LTV CRITERIA**

The valuation rules of the cover assets determine the maximum amount of Belgian pandbrieven that can be issued. The value of the cover assets of each of the categories as mentioned in the section above, will be determined as follows:

- > category 1: minimum of [the outstanding loan amount, 80% of the value of the mortgaged property, the mortgage inscription amount<sup>4</sup>]
- > category 2: minimum of [the outstanding loan amount, 60% of the value of the mortgaged property, the mortgage inscription amount]
- > category 3: value is equal to the book value (nominal amount outstanding), except when the counterparties are not part of the EU in which case the value will be zero. There is however an exception to this zero valuation rule for non-EU counterparty exposure:
  - > a) in case the non-EU counterparties qualify for credit quality step 1, or
  - > b) in case the non-EU counterparties qualify for credit quality step 2 and do not exceed 20% of the nominal amount of Belgian pandbrieven issued
 in either case the value is equal to the book value.

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<sup>4</sup> This can include Belgian mortgage mandates but upon the condition that there is a first lien mortgage inscription of at least 60% related to one and the same property.

- > category 4: no value can be given to this category unless:
  - > a) the counterparty must qualify for credit quality step 1, or
  - > b) in case the counterparty qualifies for a credit quality step 2, the maturity does not exceed 100 days as of the moment of registration in the cover pool
 in either case the value is equal to the book value.
- > category 5: no value is given to this category.
- > Additional valuation rule applicable to any category: in case of delinquencies above 30 days, the value as determined per category is reduced by 50%. In case of default, no value can be given anymore.

When it comes to property valuation (applicable to cat 1 and cat 2), in general in Belgium every property is valued during the underwriting process based on either the notarial deed (that includes the property sale price) and/or in case of construction, the financial plan of the architects. It is rather rare that the valuation is based on the report of an accredited third party appraiser.

Note that assets can be part of the cover pool without necessarily having a value attached to it, like is the case for the derivatives category but as well for example for risk on financial institutions with a maturity above 100 days and a rating below AA-.

## **V. ASSET-LIABILITY MANAGEMENT**

Each issuer will be required to perform several asset cover tests. The first one has been already mentioned in section III and requires that the value of either category 1,2 or 3 is at least 85% of the nominal amount of Belgian pandbrieven. Secondly the value of the cover assets needs to exceed the nominal amount of Belgian pandbrieven by 5% at all times (5% overcollateralization). Finally the sum of the interest, principal and other revenues needs to be sufficiently high to cover for the sum of interests, principal and other costs linked to the Belgian pandbrieven, as well as any other obligation of the Belgian pandbrieven program.

Next to the asset cover tests, a liquidity test will have to be performed whereby the issuer will calculate its maximum liquidity need within the next 180 days. This amount has to be covered by liquid cover assets. A liquidity facility could be used to cover liquidity needs, as long as it is not provided by a group related entity of the issuer. What can be included as other liquid cover asset still needs to be determined by the NBB.

The issuer will also be required to manage and limit its interest and currency risk related to the program and be able to sustain severe & adverse interest/exchange rate movements. Although it is the issuer's sole discretion to determine how this will be managed (e.g. adding derivatives to the cover pool is a possibility (subject to eligibility criteria) but not an obligation) it needs to be documented in the license application.

Other safeguard mechanism that will be foreseen:

- > Issuer will have the possibility to retain its own Belgian pandbrieven for liquidity purposes
- > Commingling risk:
  - > collections received from cover assets as of the date of bankruptcy or beginning of liquidation will by law be excluded from the insolvent general estate
  - > registered collections received from the cover assets before the date of bankruptcy or beginning of liquidation, are part of the separate estate and legally protected via the right of 'revindication'
- > Set-off and claw back risk: separate legislation in progress to legally solve this

- > Following the bankruptcy of the issuer, the separate legal estate will maintain a (limited and extinguishing) banking license

## **VI. COVER POOL MONITOR AND BANKING SUPERVISION**

In its capacity as a Belgian credit institution licensed to issue Belgian pandbrievens, the issuer is subject to special supervision by the NBB as well as the supervision of a cover pool monitor.

The cover pool monitor:

- > is chosen by the issuer from those persons appearing on the official list of certified/statutory auditors established by the NBB;
- > shall be appointed for a period of [x] years subject to prior approval from the NBB (however, such appointment should be able to be revoked by the NBB in case of objective reasons);
- > neither the certified/statutory auditor of the issuer, nor the certified/statutory auditor of any company controlling the issuer can be chosen.

The main tasks of a cover pool monitor consist of ensuring compliance with legal and regulatory requirements, e.g. are the cover assets duly recorded in the register, do the cover assets fulfil the eligibility criteria, is the value correctly registered, etc. Next to that the cover pool monitor has a reporting obligation towards the NBB on several aspects such as level of overcollateralization and results of the different tests that have to be performed. The issuer is obliged to provide full cooperation to the cover pool monitor and shall give the cover pool monitor the right to review the register, loan documents, accounting book, or any other document. The frequency and detailed procedures of any of the tasks of the cover pool monitor still need to be worked out by the NBB in its regulations.

The NBB is also allowed to perform audits (independent from the cover pool monitor) at its discretion.

If the NBB considers that a category of Belgian pandbrievens no longer fulfills the criteria or the issuer no longer fulfills its obligations, it can withdraw the license of the issuer and consequently withdraw the issuer from the list. Such a deletion from the list will be reported to the European Commission but does not have consequences for existing Belgian pandbrievens holders.

## **VII. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS**

Assets need to be registered before they form part of the segregated estate. The law protects these registered assets (including all collateral and guarantees related to such assets) in the segregated estate from the creditors of the insolvent general estate, so they are therefore not affected by the start of insolvency proceedings against the issuer. Also any assets that would be posted via the CSA that is in place, would be protected from insolvency proceedings as it is required to register these type of assets as well, although as explained before one cannot consider those as pure cover assets.

The cover assets once registered are exclusively and by operation of law reserved for the benefit of the Belgian pandbrievens investors and other creditors that might be linked to the program (e.g. a swap counterparty of which the derivative is included in the cover pool). These creditors also have a claim on the general estate. Only when all obligations at program level have been satisfied, will any remainder of assets of the separate legal estate return to the general estate of the issuer. The bankruptcy receiver of the credit institution, in consultation with the NBB, could ask the restitution of cover assets if and

when there is certainty that not all assets will be necessary to satisfy the obligations under the Belgian pandbrieven program.

At the moment of the opening of insolvency procedures of the credit institution, or even before whenever the NBB considers it to be necessary (e.g. at the moment the license is withdrawn), a portfolio manager ("gestionnaire de portefeuille") will be appointed that will take over the management of the Belgian pandbrieven program from the credit institution. The portfolio manager (appointed by the NBB) will have the authority to dispose of assets and will, in consultation with/upon approval of both the NBB and the representative of the noteholders, take all such actions required to fulfill in a timely manner the obligations under the Belgian pandbrieven. Such actions could consist in (partial) sale of the underlying cover assets, taking out a loan, issuance of new bonds to use for ECB purposes or any other action that might be needed to fulfill the obligations. Acceleration of the Belgian pandbrieven is not possible, unless:

- > noteholders would decide otherwise;
- > it is clear that further deterioration of the cover assets would lead to a situation whereby it is impossible to satisfy the obligations under the Belgian pandbrieven (i.e. in a situation of insolvency of the cover pool).

#### **VIII. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

Belgian pandbrieven will comply with the requirements of Art. 52 par. 4 UCITS Directive and of the CRD Directive, Annex VI, Part 1, Paragraph 68 a) to f) if and to the extent they are listed by the NBB as such.