

3.4 BELGIUM

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I. FRAMEWORK

On 3 August 2012, the Belgian Parliament adopted the legislation on covered bonds. This law provides a statutory framework for the issuance of covered bonds by Belgian credit institutions.

The legal basis for Belgian covered bonds is incorporated into the banking law, meaning the law of 25 April 2014 on the status and the supervision of credit institutions (the "Banking Law") that replaced the Act of 22 March 1993 on the status and the supervision of credit institutions. Since 11 October 2012 the legislation with respect to Belgian covered bonds has been supplemented by two Royal Decrees (a general Royal Decree on the issuance of covered bonds and a specific Royal Decree dedicated to the cover pool administrator) and several regulations (inter alia concerning the issuer reporting requirements).

The following gives an overview of the legislative framework for Belgian covered bonds:

- > The Law of 3 August 2012 establishing a legal regime for Belgian covered bonds, which is implemented in the Law of 25 April 2014 on the status and supervision of credit institutions (*Wet van 25 april 2014 op het statuut van en het toezicht op kredietinstellingen/Loi du 25 avril 2014 relative au statut et au contrôle des établissements de crédit*) (the "**Banking Law**");
- > The Law of 3 August 2012 on various measures to facilitate the mobilisation of claims in the financial sector (the "**Mobilisation Law**");
- > The Royal Decree of 11 October 2012 on the issuance of Belgian covered bonds by Belgian credit institutions (the "**Covered Bond Royal Decree**");
- > The Royal Decree of 11 October 2012 on the cover pool administrator in the context of the issuance of Belgian covered bonds by a Belgian credit institution (the "**Cover Pool Administrator Royal Decree**");
- > The Regulation of the National Bank of Belgium ("NBB") concerning the practical modalities for the application of the Law of 3 August 2012 that establishes a legal regime for Belgian covered bonds dated 29 October 2012 (the "**NBB Covered Bonds Regulation**"); and
- > The Regulation of the National Bank of Belgium addressed to the statutory auditors and the cover pool monitors of Belgian credit institutions with respect to their involvement in the context of the issuance of Belgian covered bonds in accordance with Chapter VIII of the Law of 22 March 1993 dated 29 October 2012 (the "**NBB Cover Pool Monitor Regulation**").

II. STRUCTURE OF THE ISSUER

Belgian covered bonds can be issued by universal credit institutions¹ established in Belgium. However such institutions first need to be licensed by the NBB as covered bond issuer (general authorisation as issuer) and also the covered bond program itself needs to get approval from the NBB (specific program license).

An extensive issuer license file detailing aspects like its strategy, solvency, risk management, asset encumbrance, IT systems, internal audit, etc. needs to be submitted. At program level the issuer has to detail the impact of the covered bond issuance on its overall liquidity, the quality of the cover assets and maturity matching of assets/liabilities in the program. The statutory auditor of the issuer has to report to the NBB on the organizational capacity of the credit institution to issue and follow up the covered bonds.

¹ Existing credit institutions could decide to issue themselves or to issue from a newly created credit institution. The latter would typically but not necessarily be a subsidiary or an affiliate of the mother company.

The license 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) are added to specific lists that are available for consultation on NBB's website.

An indirect issuance limit on covered bonds has been integrated in the Covered Bond Royal Decree by limiting the amount of cover assets to 8% of the Belgian GAAP balance sheet.

At program level a distinction is made between Article 129 CRR²-compliant covered bonds, i.e. "Belgian pandbrieven/lettres de gage", and non-Article 129 CRR-compliant (but still UCITS 52(4) 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. 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

However the way that the Banking Law and the Royal Decree are stipulated, makes that in practice the Belgian credit institutions are only able to issue Article 129 CRR-compliant covered bonds. Therefore in what follows we will only concentrate on the Belgian pandbrieven.

When a credit institution issues Belgian pandbrieven, its assets consist by operation of law of its general estate on the one hand and (one or more) separate, ringfenced "segregated estate(s)" ("patrimoine special") on the other hand (=balance sheet structure, no use of a special purpose vehicle).

The Belgian pandbrieven investors 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 comprises the cover pool that is exclusively reserved for the Belgian pandbrieven investors under the specific program to which the segregated estate is joined and for the claims of other parties that are or can be identified in the issue conditions. Assets become part of the cover pool upon registration in a register held by the issuer for such purpose. As of that moment these assets form part of the segregated estate and are excluded from general bankruptcy clawback risk.

When insolvency proceedings are opened with regard to the issuing credit institution, by operation of law, the assets recorded in the segregated estate do not form part of the insolvent general estate and hence are not affected by the opening of the insolvency proceedings. Upon insolvency of the credit institution, Belgian pandbrieven investors fall back on the cover pool assets (= the segregated estate) for the timely payment of their bonds but at the same time they continue to have a claim against the insolvent general estate. Creditors that are not related to the segregated estate do not have any recourse to these cover pool assets.

III. COVER ASSETS

All assets and instruments that are legally segregated for the benefit of the Belgian pandbrieven investors in a segregated 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: exposure on financial institutions
- > category 5: derivatives

² Regulation 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms (the "Capital Requirements Regulation" or "CRR").

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; for category 3 non-EU public sector exposure will get a zero valuation, unless specified otherwise.
- > with respect to the MBS/ABS as mentioned in each of the first three categories: senior 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 senior ABS/MBS must qualify for credit quality step 1 (as set out in Article 251 CRR). The securitization vehicle of the ABS/MBS must be located in the EU. At last these securitization tranches only remain eligible as cover asset within the limits imposed by Article 129 CRR;
- > 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; Residential real estate is defined as real estate property that is destined for housing or for leasing as housing by the owner. Commercial real estate is real estate property that is primarily used for industrial or commercial purposes or for other professional activities such as offices or other premises intended for the exercise of a commercial or services activity;
- > 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 article 117 CRR;
- > for category 5: derivatives, of which the counterparty has a low default risk (meaning a counterparty that qualifies for credit quality step 1 or step 2 as set out in Article 120 CRR), 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 Article 120 CRR) and forms part of the EEA, and (ii) it has a (unilateral) credit support annex (CSA) in place. Note that assets posted under the CSA would belong to the separate legal estate, but are not considered as cover assets 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 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 for each program that is set up (and accordingly for each segregated estate), 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 outstanding under such program. 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 amount³]
- > 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 both cases the value is equal to the book value.
- > category 4: no value can be given to this category unless:
 - > a) the counterparty qualifies 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 both cases 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 (> 90 days), 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 in Belgium that the valuation is based on the report of an accredited third party appraiser.

In line with the NBB Covered Bonds Regulation, the market value will have to be justified in a clear and transparent manner on the basis of a document established by a person who is independent from the persons who are in charge of granting the relevant loans. An expert report is required for real estate which has a value of more than 3 million euro or 2% of the amount of the relevant covered bonds. Otherwise, the value of the real estate can be determined on the basis of the sales value as established in the notarial deed at the time of sale or the valuation report of the architect in the case of real estate in construction. The credit institution must apply a prudent revaluation procedure to determine the current value.

The value of the real estate has to be tested regularly. A more frequent control shall occur in case of significant changes to the market conditions. For the regular re-appraisal of the value of the real estate, customary methods and benchmarks (such as third party indices) may be used.

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 exposure on financial institutions with a maturity above 100 days and a rating below AA-.

³ 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.

V. ASSET-LIABILITY MANAGEMENT

Each issuer is 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 (the "**85% asset coverage test**"). Secondly the value of the cover assets has to exceed the nominal amount of Belgian pandbrieven by 5% at all times (5% overcollateralization) (the "**overcollateralization test**"). Finally the sum of the interest, principal and other revenues has to be sufficiently high to cover for the sum of interests, principal and other costs due under/with regard to the Belgian pandbrieven, as well as any other obligation of the Belgian pandbrieven program (the "amortization test").

Next to the asset cover tests, a liquidity test has to be performed whereby the issuer calculates its maximum liquidity need within the next 180 days (the "**liquidity test**"). This amount has to be covered by (sufficient) liquid cover assets. In order to meet the test, 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. Liquid assets are assets that (i) meet the cover asset eligibility criteria and (ii) qualify as liquid assets under the Regulation of the Banking Finance and Insurance Commission (CBFA) of 27 July 2010 on the liquidity of credit institutions, financial holdings, clearing institutions and institutions assimilated with clearing institutions.

If an issuing credit institution fails to meet the requirements of the liquidity test, it has 14 days to take the necessary redress measures to meet the relevant requirements. As long as an issuing credit institution has not taken the necessary redress measures, it is not allowed to issue new Belgian covered bonds.

The issuer is also required to manage and limit its interest and currency risk related to the program and will be able to sustain severe & averse 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), the policy needs to be documented in the license application.

At last it is important to highlight that the tests have to be met on a daily basis.

It is the task of the cover pool monitor to verify at least once a month if the issuer is compliant with all the tests.

Other safeguard mechanism that are 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 will by law be excluded from the insolvent general estate
 - > registered collections received from the cover assets before the date of bankruptcy are part of the separate estate and legally protected via the right of 'revindication'. This is a special mechanism that has been created to protect cash held by the issuer for the account of the segregated estate. Pursuant to this mechanism, the ownership rights of the special estate as regards cash that cannot be identified in the general estate, will be transferred to unencumbered assets in the general estate that will be selected by taking into account criteria specified in the issue conditions.
- > Set-off and claw back risk have been addressed by the Mobilisation Law.

VI. TRANSPARENCY

All market participants provide extensive data in their monthly reporting under a similar format.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

In its capacity as a Belgian credit institution licensed to issue Belgian pandbrieven, the issuer is subject to special supervision by the NBB as well as the supervision by 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 subject to prior approval from the NBB;
- > cannot be the certified/statutory auditor of the issuer.

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. The cover pool monitor is required to perform these tasks not only on an on-going basis, but also prior to the first issuance of Belgian pandbrieven by the credit institution. The on-going verifications must be done at least once a month.

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 NBB at its discretion can ask the cover pool monitor to perform other tasks and verifications.

If the NBB considers that a category of Belgian pandbrieven 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 of Belgian covered bond issuers. Such a deletion from the list will be reported to the European Commission but does not have consequences for existing Belgian pandbrieven holders.

VIII. 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) from a claim of the creditors of the insolvent general estate and therefore they are not affected by the start of insolvency proceedings against the issuer. Also, any assets that would be posted via a 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 pandbrieven 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 estate return to the general estate of the issuer. Before such time, 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.

Upon the initiation of bankruptcy proceedings or the instruction of an exceptional recovery measure by the competent supervisor with regard to the credit institution, or even before whenever the NBB considers it to be necessary (e.g. at the moment the license is withdrawn), a cover pool administrator (“gestionnaire de portefeuille”) will be appointed that will take over the management of the Belgian pandbrieven program from the credit institution. The cover pool administrator (appointed by the NBB) is legally entrusted with all powers that are necessary for the management of the segregated estate, and can take all such actions (some in consultation with/upon approval of both the NBB and the representative of the noteholders) 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 after the appointment of a cover pool administrator:

- > noteholders would decide otherwise;
- > (after consultation with the noteholders’ representative and with the consent of the NBB) 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).

The bankruptcy receiver has a legal obligation to cooperate with the NBB and the cover pool administrator in order to enable them to manage the special estate in accordance with the law.

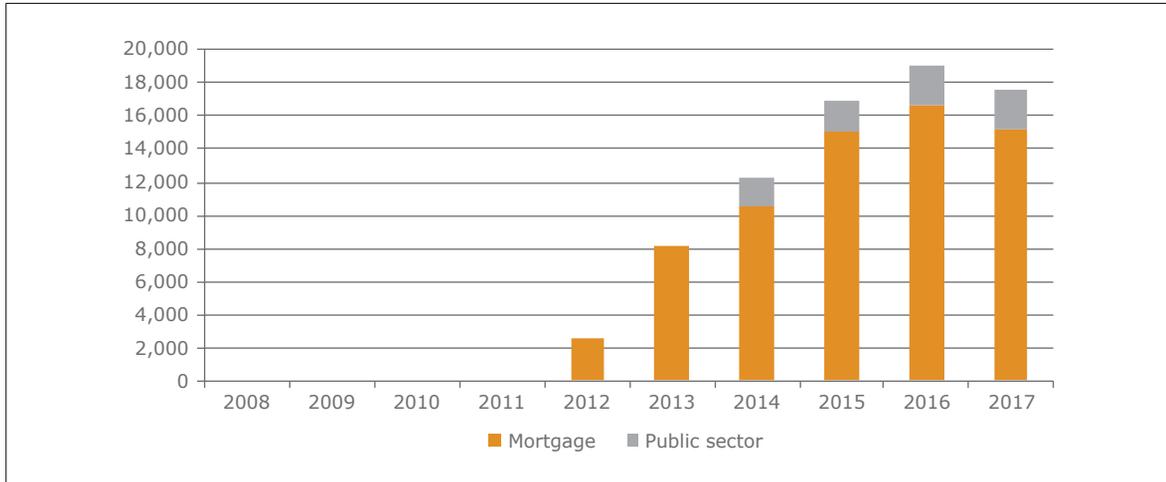
The Cover Pool Administrator Royal Decree specifies the tasks of the cover pool administrator. These include, amongst other things, to procure the payment of interest and principal on the Belgian covered bonds, collection of moneys from the cover assets (including any enforcement), entering into relevant hedging and liquidity transactions and carrying out of certain administrative tasks. The cover pool administrator will also have to test compliance with the cover tests and inform the NBB and the noteholders’ representative thereof.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The legislation when taken together with the practices, processes and procedures across the industry should fall within the criteria of Article 129 CRR.⁴ Belgian pandbrieven comply with the requirements of Article 52(4) UCITS and Article 129 CRR if and to the extent they are listed by the NBB as such.

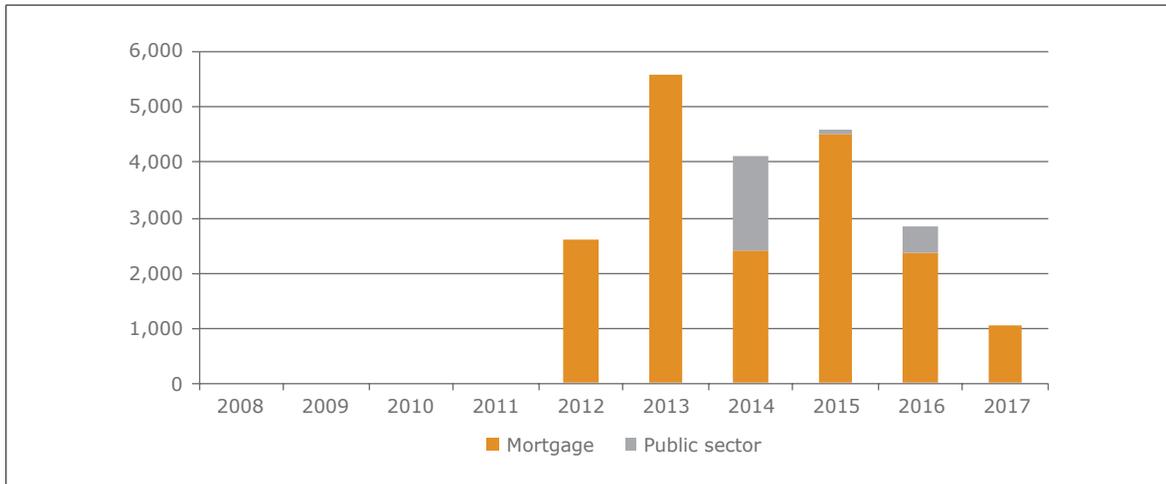
⁴ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hypos.org/ecbc/covered-bonds/>.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2008-2017, EUR M



Source: EMF-ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

Issuers: Belfius, BNP Paribas Fortis, KBC and ING Belgium.

ECBC Covered Bond Comparative Database: http://www.ecbc.eu/framework/100/Belgium_Covered_Bonds.



COVERED BOND LABEL
BNP Paribas Fortis NV/SA (1 pool).