

### **3.9 FINLAND**

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#### **I. FRAMEWORK**

In Finland, the legal basis for covered bond issuance is the Act on Mortgage Credit Bank Operations (HE 42/2010). The new legal framework replaced the old Act on Mortgage Credit Bank (1999) and entered into force on 1 August 2010. The new law overruled the special banking principle and gathered all Mortgage Credit Bank related legislation under same act. Besides other technical changes, e.g. mixed pools have been allowed.

The provisions of the new legal framework do not apply to covered bonds issued or derivatives contracts registered before the entering into force of the new act.

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

The issuer of Finnish Covered Bonds can still be a specialized bank, but deposit banks or credit entities are entitled to apply for a license to issue covered bonds. The existing specialized banks tend to stay in business in the way they have been operating since being established.

The issuer holds the cover assets on the balance sheet. A subsequent transfer of the cover assets to another legal entity is not taking place. A direct legal link between single cover assets and the Covered Bonds issued does not exist. All obligations from Finnish Covered Bonds are direct and unconditional obligations of the issuing bank as a whole. In the case of insolvency, the cover pool is segregated by law from the general insolvency estate and is reserved only for the claims of the holders of Finnish Covered Bonds.

Under the previous legal framework, only Bonds covered by mortgages were issued by Finnish mortgage banks. A separate cover pool was to be established if these banks were to start the issuance of public-sector backed Finnish Covered Bonds. Under the new law, mixed pools comprising mortgage loans as well as eligible public sector assets are allowed.

#### **III. COVER ASSETS**

The geographical scope of cover assets is restricted to the European Economic Area (EEA).

Residential mortgage loans, shares in housing companies as well as commercial mortgage loans up to 10 % of the total pool are eligible as cover assets.

Public sector loans in accordance with the CRD Directive, Annex VI, Part 1, Paragraph 68 a) to f) criteria are also eligible.

A new feature in the law is that a specialized mortgage credit bank can grant an intermediate credit to a deposit bank or a credit entity. This intermediate credit must be covered with eligible cover assets as stated above. These assets must also be recorded into the cover register.

Up to 20% of the mortgage cover pool is allowed to consist of substitute cover assets; bonds and other debt obligations issued by the State, a municipality or another public-sector organisation or another credit institution than one belonging to the same consolidation group as the issuer; a guarantee as for own debt granted by a public-sector organisation or credit institution referred above; a credit insurance given by an insurance company other than one belonging to the same group, referred to in the Act on Supervision of Finance and Insurance Groups; cash assets of the issuer deposited in the Bank of Finland

or a deposit bank with the restriction that if the issuer is a deposit bank the cash deposit may not be in a deposit bank belonging to the same consolidation group as the issuer.

ABS or MBS tranches are not eligible for the cover pool.

Derivatives are eligible for the cover pools only if they are used for hedging purposes.

The nature of the cover pool is dynamic. Currency risk is perfectly matched as the law requires cover assets to be in the same currency as the covered bonds.

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

The property valuation within the legal framework for Covered Bonds in Finland is based on market values. There are different LTV levels for residential and commercial mortgage loans: 70% of the value of the residential property and 60% of the value of the commercial property accepted. This LTV is a relative limit, i.e. when a loan exceeds the 60%/70% limit, the part of the loan up to 60%/70% LTV remains eligible to the cover pool. A loan placed as collateral for a covered bond may not exceed the current value of the property standing as collateral.

##### Asset-liability Management

There are legal standards for Asset-Liability Matching in the Finnish Covered Bond System. For instance, the aggregate interest received on the cover assets in any 12-month period must exceed the interest paid on the outstanding Covered Bonds. This regulation takes derivatives for hedging purposes into account.

The total amount of collateral of covered bonds shall continuously exceed the remaining combined capital of the covered bonds.

The net present value of the total amount of collateral of covered bonds shall continuously exceed by at least 2 per cent the total net present value of the payment liabilities resulting from the covered bonds

In case of a breach of one of these rules mentioned, the issuer might face sanctions from the FSA. Ultimately, the issuer might face the loss if its licence.

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

The issuer carries out the monitoring of the cover pool. Therefore, the issuer reports to the FSA on a monthly basis. With regard to UCITS 52(4), this supervision of a specialized bank as issuer of the Covered Bond is compliant to the "special supervision". The FSA has the legal power to take appropriate measures. It is allowed to conduct inspections at the bank in question or to require documents. Also, the FSA could issue a public warning or admonition. Ultimately, it is up to the FSA to revoke the banking licence of the bank in question.

#### **VI. HOW ARE SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS REGULATED?**

A cover register allows identifying the cover assets. The legal effect of a registration of assets into the cover register is to create the priority claim of Covered Bond holders to these cover assets in case of an insolvency of the issuer. The cover register is managed by the corresponding bank, which in turn is supervised by the FSA.

The cover register contains information about the principle amount of Covered Bonds issued, the mortgages and substitute assets covering these bonds as well as derivative transactions hedging these bonds or funds placed as their collateral.

### **Asset segregation**

The cover pool is a part of the general estate of the bank as long as the issuer is solvent. If the insolvency proceedings are opened, by operation of law, the assets recorded in the cover registers are excluded from the general insolvency's estate. When the insolvency proceedings are opened, the FSA appoints a special cover pool administrator. Within the insolvency procedure, the derivative counterparties rank pari passu to Covered Bond holders. The cover assets do form a separate legal estate, which is ring-fenced by law from other assets of the issuer.

### **Impact of insolvency proceedings on covered bonds and derivatives**

Covered Bonds do not automatically accelerate when the issuing institution becomes insolvent. The legal consequences for the derivatives in case of an insolvency of the issuing bank depend on the relevant contracts.

### **Preferential treatment of Covered Bond holders**

Covered Bond holders enjoy a preferential treatment as the law stipulates the separation of the cover assets on the one hand and the insolvency's estate on the other.

The satisfaction of the Covered Bond holders is not limited to the cover assets in the Finnish system. On the contrary, those creditors also participate in the insolvency proceedings in respect of the remaining assets of the bank.

A moratorium on the insolvency's estate cannot delay the cash flows from the cover assets and, therefore, endanger the timely payment of Covered Bond holders.

### **Access to liquidity in case of insolvency**

With the appointment of the cover pool administrator, this person acts on behalf of the Covered Bond holders. The pool administrator has access to the cover assets. Cover assets may only be disposed with the consent of the FSA. Additionally, the pool administrator has also the first access on cash flows generated by the cover assets. The law foresees a possibility for the pool administrator together with the bankruptcy trustee to take up a loan on behalf of the cover pool to create more liquidity.

Up to 20% of the cover pool may consist of liquid substitute cover assets. With the consent of the FSA, this limit may even be higher. As all cover assets entered into the cover register are ring-fenced in case of an insolvency of the issuer, this results also in the insolvency remoteness of voluntary over-collateralisation.

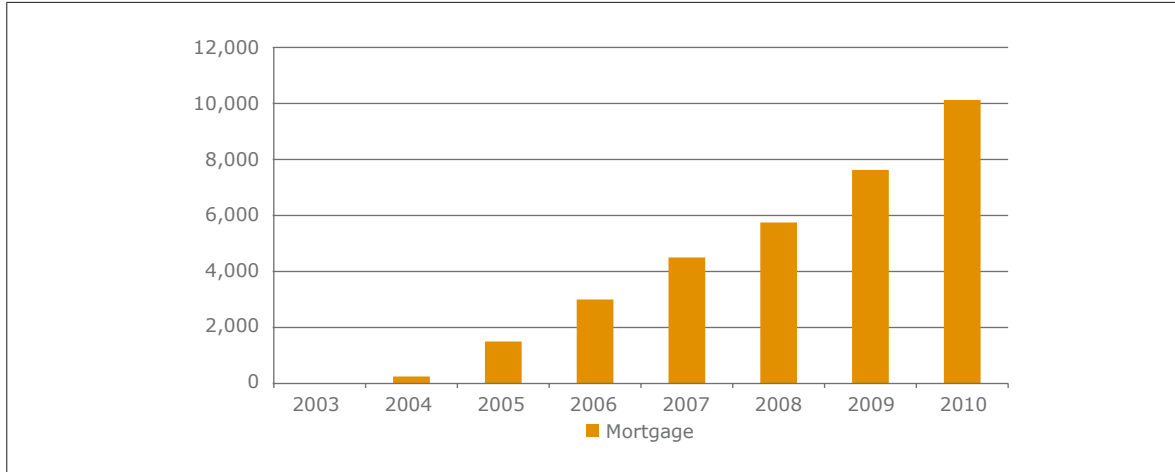
## **VII. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION**

Finnish Covered Bonds comply with the requirements of Art. 52 par. 4 UCITS Directive as well as with those of the CRD Directive, Annex VI, Part 1, Paragraph 68 a) to f). Therefore, these bonds are 10% risk weighted in Finland. Following the common practice in Europe, they accordingly enjoy a 10% risk weighting in most European countries.

Finnish Covered Bonds are also eligible in repo transaction with national central bank, i.e. within the Euro-zone.

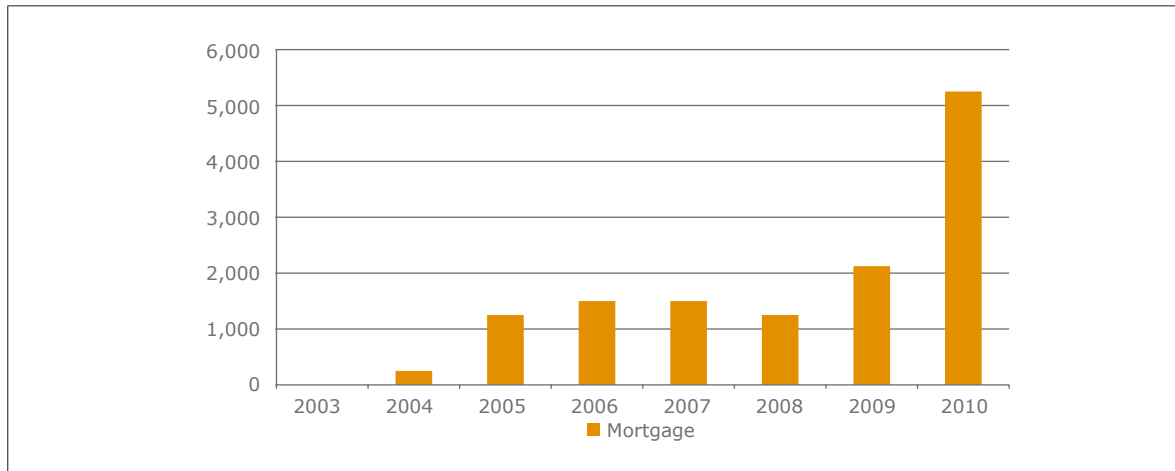
As far as the domestic issuers are aware, there are no further specific investment regulations regarding Finnish Covered Bonds.

> FIGURE 1: COVERED BONDS OUTSTANDING, 2003-2010, EUR M



Source: EMF/ECBC

> FIGURE 2: COVERED BONDS ISSUANCE, 2003-2010, EUR M



Source: EMF/ECBC

**Issuers:** Finnish issuers at the end of 2010 were Aktia Real Estate Mortgage Bank, Nordea Bank Finland, OP Group Mortgage Bank and Sampo Housing Loan Bank.