

### **3.18 IRELAND**

By Sinéad Gormley, Bank of Ireland and Nick Pheifer, DEPFA BANK

#### **I. FRAMEWORK**

Irish covered bonds benefit from the protection of specific covered bond legislation in the Irish Asset Covered Securities Acts 2001 and 2007 (the "ACS Acts") and the regulations and regulatory notices issued thereunder. The framework provides for the issuance of asset covered securities ("ACS") secured on public credits, mortgage credits (each, as defined below) and commercial mortgage credits (being obligations secured on commercial property assets). There is currently no issuer of ACS secured on commercial mortgage credits in the Irish market and consequently this chapter focuses on the framework applicable to ACS secured on public credits and mortgage credits.

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

An issuer of ACS (an "ACS Issuer") must be authorised, or be deemed to be authorised, as a credit institution under Council Regulation (EU) No 1024/2013 (the "SSMR") and also be registered under the ACS Acts as a designated credit institution. It is required to limit the scope of its banking activities to certain permitted business activities. An ACS Issuer is therefore subject to supervision by the European Central Bank and by the Central Bank of Ireland (the "CBI") in its capacity as a credit institution and separately by the CBI in its capacity as an ACS Issuer. Each ACS Issuer will be registered as a designated public credit institution (authorised to issue public credit covered securities) and/or a designated mortgage credit institution (authorised to issue mortgage credit covered securities).

The ACS Issuer holds the assets backing the ACS on its balance sheet. The collection of either mortgage credit assets or public credit assets (the "cover assets") backing the issue of ACS (the "cover pool") is described as dynamic or open in the sense that the ACS Issuer may move cover assets in and out of the cover pool provided that it does so in accordance with the provisions of the ACS Acts. One such control is that the ACS Issuer must maintain a register (a "cover register") of all ACS issued, all cover assets hedge contracts and the cover assets (including any substitution assets and any cover assets constituting over-collateralisation) and any amendment to the cover register can only be effected with the approval of a cover-assets monitor (the "CAM") which is an independent professional third party, or the CBI (see further section VII below).

#### **Statutory preference**

The claims of ACS holders are protected by a statutory preference under the ACS Acts. As preferred creditors, upon an ACS Issuer insolvency, ACS holders are entitled to have recourse to the cover assets included in the cover pool ahead of all other creditors of the ACS Issuer other than the super-preferred creditors (i.e. the CAM and NTMA – see further section VIII below) and pari passu with other preferred creditors (such as the pool hedge counterparties – see further section V below). In this way the ACS holders have protection against the general Irish insolvency laws.

#### **Restriction on business activities**

The ACS Acts provide that an ACS Issuer may not carry on a business activity other than a permitted business activity as set out in the ACS Acts. Permitted business activities comprise dealing in and holding public credit assets or mortgage credit assets (depending on the type of designation of ACS Issuer) and limited classes of other assets, engaging in activities connected with the financing and refinancing of such assets, entering into certain hedging contracts, holding collateral under cover assets hedge contracts (referred to in the ACS Acts as "pool hedge collateral") and engaging in other activities which are incidental or ancillary to these activities. The ACS Acts limit the scope of non-core ACS business that an ACS Issuer can undertake by restricting its dealing in or holding of financial assets that are not otherwise eligible for inclusion in the cover pool to 10% of the total of all the ACS Issuer's assets. There is also a similar 10% limit imposed on the volume of non-cover

pool-eligible OECD assets that an ACS Issuer can acquire. In addition, designated mortgage credit institutions must maintain the aggregate prudent loan to value ("LTV") of their overall mortgage books at or below 100%.

### **III. COVER ASSETS**

The classes of assets which are eligible for inclusion in a cover pool are determined by whether the ACS Issuer is a designated public credit institution or a designated mortgage credit institution.

#### **Designated public credit institutions**

The classes of asset eligible for inclusion in the cover pool of a designated public credit institution ("public credit assets") are financial obligations (collectively, "public credits"), including obligations given as a guarantor or surety and indirect or contingent obligations, in respect of money borrowed or raised (whether in the form of a security that represents other public credit that is securitised or not) where the obligor is any one of the following:

- > Central governments, central banks (each, a "Sovereign"), public sector entities, regional governments or local authorities (each, a "Sub-sovereign") in any EEA country;
- > Sovereigns in Australia, Canada, Japan, New Zealand, the Swiss Confederation or the USA (each, an "Eligible Non-EEA Country");
- > Sub-sovereigns in any Eligible Non-EEA Country; and
- > Multilateral development banks or international organisations, in each case which qualify as such for the purposes of the Capital Requirements Regulation ("CRR").

Risk-weighting and credit worthiness tests apply to the categories of cover assets outside the EEA countries to comply with the CRR covered bond eligibility requirements. Sovereign obligations from an Eligible Non-EEA Country must have an independent credit rating of at least step 1. Sub-sovereign obligations from an Eligible Non-EEA Country must have an independent credit rating of at least step 1 and a risk-weighting at least equal to that of an institution, central government or central bank. Sovereign and Sub-sovereign obligations from an Eligible Non-EEA Country with credit ratings below step 1 but at least step 2 may also be included in the cover pool provided that in total they do not exceed 20% of the nominal amount of outstanding ACS.

#### **Designated mortgage credit institutions**

Those assets eligible for inclusion in the cover pool of a designated mortgage credit institution ("mortgage credit assets") are financial obligations (collectively, "mortgage credits"), including obligations given as a guarantor or surety and indirect or contingent obligations, in respect of money borrowed or raised (whether in the form of a security that represents other mortgage credit that is securitised or not) that are secured by a mortgage, charge, or other security on residential or commercial property that is located in any EEA country or any eligible Non-EEA country. This is subject to a concentration limit, for mortgage credit assets secured on commercial property, of 10% of the total prudent market value of all mortgage credit assets and substitution assets in the cover pool. Non-performing mortgage credit assets may not be included in a cover pool. Furthermore, a mortgage credit asset may not be counted as part of a cover pool if a building related to that mortgage credit asset is being or is to be constructed until the building is ready for occupation as a commercial or residential property. A mortgage credit institution may also include securitised mortgage credits in its cover pool subject to certain credit quality and other criteria and a concentration limit of 10% of the aggregate value of the related outstanding ACS.

#### **Substitution assets**

Substitution assets can be included in any cover pool provided that they comply with applicable CRR requirements and certain other restrictions. These are deposits having a minimum credit rating of Step 2 and a maximum maturity of 100 days with eligible financial institutions.

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

##### **Designated public credit institution**

Public credit assets maintained in the cover pool of a designated public credit institution are ascribed a prudent market value equal to 100% of the amount of the related public credit outstanding on the date of valuation.

##### **Designated mortgage credit institution**

The maximum prudent LTV levels for mortgage credit assets included in the cover pool of a mortgage credit institution are 75% for mortgage credit assets backed by residential property and 60% for those backed by commercial property. Prudent LTV levels for mortgage credit assets in the cover pool can exceed the 75% threshold, however the balance of the mortgage credit above this threshold is disregarded for valuation purposes. As noted in Section III, the inclusion in the cover pool of mortgage credit assets secured on commercial property is restricted to 10% of the prudent market value of all mortgage credit assets and substitution assets included in the cover pool at any time.

A designated mortgage credit institution is first required to determine the market value of a property asset at the time of origination of the mortgage credit asset secured on it. It is market practice for such property valuations to be conducted by independent valuers. The designated mortgage credit institution is then required to calculate the prudent market value of such property asset at the time of inclusion of the related mortgage credit asset in the cover pool and also at such intervals (at least once per year) as may be specified by the CBI. In addition, a designated mortgage credit institution is required to calculate the prudent market value of mortgage credit assets and securitised mortgage credits included in the cover pool on a quarterly basis, or more frequently if so instructed by the CAM, for the purposes of demonstrating compliance with the asset-liability and overcollateralisation requirements of the ACS Acts. In practice, the prudent market value of relevant property assets is calculated on a quarterly basis also as this calculation forms part of the valuation process for mortgage credit assets.

For these subsequent calculations, the designated mortgage credit institution must apply the house price index published by Permanent TSB and/or the house price index published by the Irish Central Statistics Office (depending on the date of origination) to the valuation obtained at origination, with same being verified by the CAM on a monthly basis.

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

The ACS Acts include important asset-liability controls to minimise various market risks.

- > Duration matching: The weighted average term to maturity of a cover pool cannot be less than that of the related ACS.
- > Overcollateralisation: The prudent market value of the cover pool must be at least 3% greater than the total of the principal amount of the related ACS in issue (see also Overcollateralisation below).
- > Interest matching: The amount of interest payable on cover assets over a 12-month period must not be less than the amount of interest payable on the related ACS over the same 12-month period.
- > Currency matching: Each cover asset must be denominated, after taking into account the effect of any cover assets hedge contract, in the same currency as the related ACS.
- > Interest rate risk control: The net present value changes on the balance sheet of an ACS Issuer arising from (i) 100bps upward shift, (ii) 100bps downward shift and (iii) 100bps twist, in the yield curve, must not exceed 10% of the ACS Issuer's total own funds at any time.

### **Hedge contracts**

Hedge contracts are used in the cover pool to minimise risks on interest rates, currency exchange rates, credit or other risks that may adversely affect the ACS Issuer's business activities that relate to an ACS or cover assets. All such hedge contracts are required to be entered on the cover register by the ACS Issuer. Once so entered, pool hedge counterparties rank as preferred creditors, pari passu with the ACS holders, provided they are not in default of their financial obligations under that hedge contract. Upon the insolvency of an ACS Issuer, a hedge contract will remain in place subject to its terms. Any collateral posted under a hedge contract by a pool hedge counterparty must be recorded on a separate register maintained by the ACS Issuer.

### **Overcollateralisation**

The ACS Acts prescribe a minimum overcollateralisation of ACS for designated mortgage credit institutions and designated public credit institutions of 3% calculated on a present value basis. It is also possible for ACS Issuers to commit by contract to higher minimum levels of overcollateralisation and the market practice has been for ACS Issuers to contractually commit to higher levels. The CAM is responsible for monitoring the levels of legislative and contractual overcollateralisation. Upon an ACS Issuer insolvency, ACS holders will benefit from any cover assets which make up the overcollateralisation to the extent of their claims.

## **VI. TRANSPARENCY**

### **Disclosure in financial statements**

All ACS Issuers are required to make specific disclosures in relation to cover assets included in their cover pools in their annual financial statements.

### **Designated public credit institutions**

A designated public credit institution is required to disclose as at the date to which its financial statements are made up:

- > the geographic location of its public credit assets and the volume and percentage of assets in each such location; and
- > details of public credit assets secured on loans to multilateral development banks and international organisations and the volume and percentage of such assets.

### **Designated mortgage credit institutions**

A mortgage credit institution is required to disclose, in respect of the date to which its financial statements are made up, details of:

- > the number of mortgage credit assets, broken down by amount of principal outstanding;
- > volume and percentage of assets in each geographic location;
- > the number and principal amounts outstanding of non-performing mortgage credit assets;
- > whether or not any persons who owed money under mortgage credit assets had, during the immediately preceding financial year (if any), defaulted in making payments in respect of those assets in excess of EUR 1,000 (so as to render them non-performing for the purposes of the ACS Acts), and if so, the number of those assets that were held in the cover pool;
- > the number of non-performing mortgage credit assets replaced with other assets;
- > the total amount of interest in arrears in respect of mortgage credit assets that has not been written off;
- > the total amounts of principal repaid and interest paid in respect of mortgage credit assets; and
- > the number and the total amount of principal outstanding on mortgage credits that are secured on commercial property.

### **Covered Bond Label and Harmonised Transparency Template**

Designated mortgage credit institutions have adopted the ECBC's Harmonised Transparency Template ("HTT") for the purposes of the ECBC's Covered Bond Label (the "Label") with effect from 1 January 2016. The HTT is completed and published on a quarterly basis together with access to archive data going back for a period of at least 9 years.

To date, two designated mortgage credit institutions have applied for and obtained the Label in respect of their ACS issuance programmes.

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

One of the key features of the ACS legislation is the rigorous monitoring role undertaken by the CAM. The CAM is appointed by the ACS Issuer with such appointment being approved by the CBI.

There are strict eligibility requirements for CAMs. A CAM must be a body corporate or partnership, comprising personnel or partners who are members of a professional representative body. It must demonstrate to the CBI that it is experienced and competent in (i) financial risk management techniques, (ii) regulatory compliance reporting and (iii) capital markets, derivatives, and, as applicable, public credit business and mortgage credit business. The CAM must also demonstrate that it has sufficient resources at its disposal and sufficient academic or professional qualifications and experience in the financial services industry to satisfy firstly, the designated credit institution and secondly, the CBI, that it is capable of fulfilling this role.

The CAM is responsible for monitoring the cover pool, the ACS Issuer's compliance with specific provisions of the ACS Acts and reporting any breaches of same to the CBI. The CAM issues regular reports to the ACS Issuer (every 1-4 weeks) and submits a report on a quarterly basis to the CBI.

Some of the CAM's principal obligations include: ensuring that the matching requirements of the ACS Acts with respect to the cover assets and the ACS are met; ensuring that the asset eligibility requirements are met; approving any inclusion in or removal from the cover register, of a cover asset, ACS or hedge contract; checking that the level of substitution assets included in the cover pool does not exceed the prescribed percentage; and ensuring that the legislative and contractual levels of over-collateralisation are maintained.

The CBI is given statutory responsibility for supervising ACS Issuers. The CBI may, with the consent of the Minister for Finance, revoke the registration of an ACS Issuer and/or suspend its business if such ACS Issuer breaches any provision of the ACS Acts. In addition, the CBI has wide-ranging powers under the Irish Central Banking legislation to impose significant fines and administrative sanctions on ACS Issuers and/or their senior management for contraventions of the ACS Acts.

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

As noted above under section II, an ACS Issuer holds its cover assets on its balance sheet. However, the cover assets are ring-fenced from the other assets of the ACS Issuer for the benefit of ACS holders by virtue of (i) their being recorded in the cover register, and (ii) a statutory preference created by the ACS Acts.

#### **Segregation: Cover register**

Each ACS Issuer must maintain a cover register including the details of its ACS in issue, the cover assets and substitution assets backing its ACS and any cover assets hedge contracts in existence. The cover register is important as a cover asset or a cover assets hedge contract cannot be described as such unless and until it is recorded on the register. Their registration is prima facie evidence of such assets and hedge contracts being included in the cover pool, entitling the ACS holders and pool hedge counterparties to benefit from the insolvency protection specified in the ACS Acts in respect of such assets and hedge contracts. An ACS Issuer may only remove or amend a register entry with the consent of the CAM or the CBI which further safeguards the interests of ACS holders.

### **Preferential treatment of ACS holders**

Once a cover asset has been entered in the cover register, it will remain a cover asset for the benefit of ACS holders and other preferred creditors until the CAM or the CBI has consented to its removal from the cover register and consequently, the cover pool. Cover assets included in a cover pool do not form part of the assets of the ACS Issuer for the purposes of insolvency until such time as the claims of ACS holders and other preferred creditors under the ACS Acts have been satisfied.

If the claims of the ACS holders (and other preferred creditors, including the pool hedge counterparties) are not fully satisfied from the proceeds of the disposal of the cover assets, such parties are, with respect to the unsatisfied part of their claims, to be regarded as unsecured creditors in the insolvency process.

### **Impact of insolvency proceedings on ACS and hedge contracts**

Upon insolvency of an ACS Issuer, all ACS issued remain outstanding and all cover assets hedge contracts will continue to have effect, subject in each case, to the terms and conditions of the documents under which they were created.

The claims of ACS holders on the cover pool are protected by operation of law. Cover assets and hedge contracts that are included in a cover pool are not liable to interference by a bankruptcy custodian or similar person whether by attachment, sequestration or other form of seizure, or to set-off by any persons, that would otherwise be permitted by law so long as claims secured by the insolvency provisions of the ACS Acts remain unsatisfied. ACS holders have recourse to cover assets ahead of all other non-preferred creditors regardless of whether the claims of such other creditors are preferred under any other enactment or any rule of law and whether those claims are secured or unsecured.

### **The role of the manager and access to liquidity in case of insolvency**

The ACS Acts makes provision for the management of the asset covered securities business of an ACS Issuer upon an ACS Issuer insolvency through the services of the Irish National Treasury Management Agency ("NTMA"). If no suitable manager can be found by the CBI or the NTMA, the NTMA will attempt to locate an appropriate body corporate as a new parent entity for the ACS Issuer. Failing that, the CBI will appoint the NTMA to act as a temporary manager until a suitable manager or new parent entity is found. Upon appointment, a manager will assume control of the cover assets, the asset covered securities business and all related assets of the ACS Issuer. The manager is required to manage the ACS business of the ACS Issuer in the commercial interests of the ACS holders and the pool hedge counterparties. The manager will have such powers as may be designated to it by the CBI under its notice of appointment. It is possible for a manager to obtain a liquidity facility through the use of a hedge contract, such hedge contract if recorded in the cover register would constitute a cover assets hedge contract for the purposes of the ACS Acts and the pool hedge counterparty would rank *pari passu* with ACS holders and any other pool hedge counterparties.

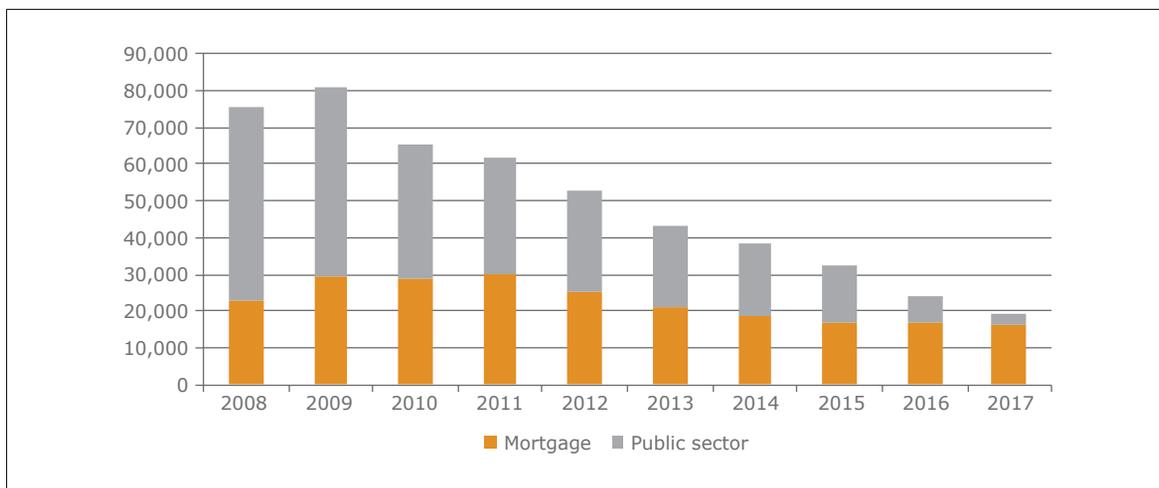
## **IX. RISK-WEIGHTING AND COMPLIANCE WITH EUROPEAN LEGISLATION**

The ACS meet the requirements of Article 52(4) UCITS. The eligibility of cover assets set out in the ACS Acts also match the criteria for the preferential risk-weighting of covered bonds set out in the CRR<sup>1</sup>.

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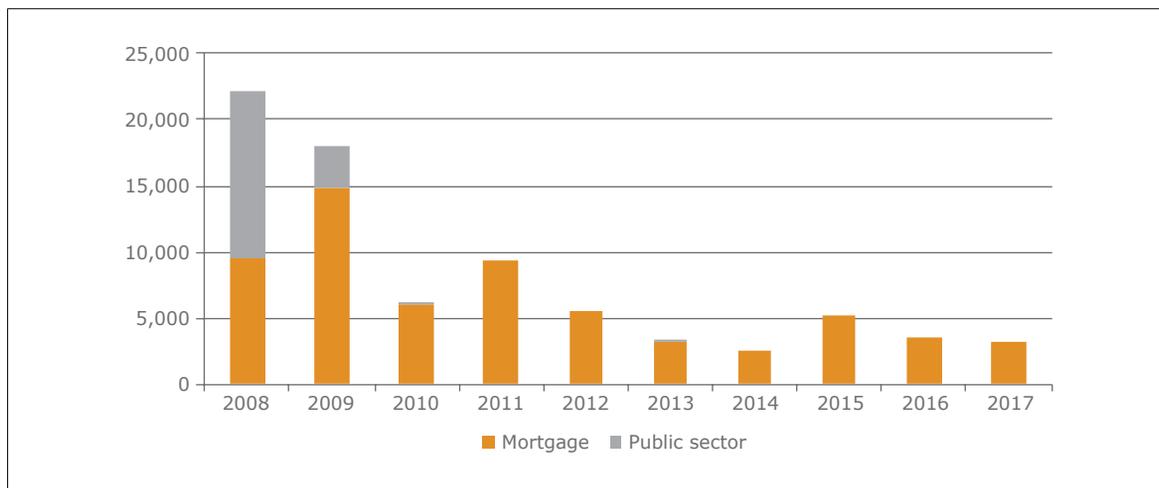
<sup>1</sup> For further information on the UCITS Directive and the Capital Requirements Regulation (CRR) please see: <https://hyppo.org/ecbc/covered-bonds/>.

> 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:** There are five ACS Issuers with outstanding covered bonds – Bank of Ireland Mortgage Bank, DEPFA ACS BANK, EAA Covered Bond Bank plc, AIB Mortgage Bank and EBS Mortgage Finance.

**ECBC Covered Bond Comparative Database:** [http://ecbc.eu/framework/28/Asset\\_Covered\\_Securities\\_-\\_ACS](http://ecbc.eu/framework/28/Asset_Covered_Securities_-_ACS).

