

3.22 THE NETHERLANDS

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I. FRAMEWORK

The Dutch regulatory framework for the issuance of covered bonds initially came into force on 1 July 2008. In order to strengthen the supervisory regime with respect to covered bonds, the Financial Supervision Act was amended in 2014, raising the legal framework for covered bonds to the level of law. The issuance of Dutch covered bonds is regulated since via:

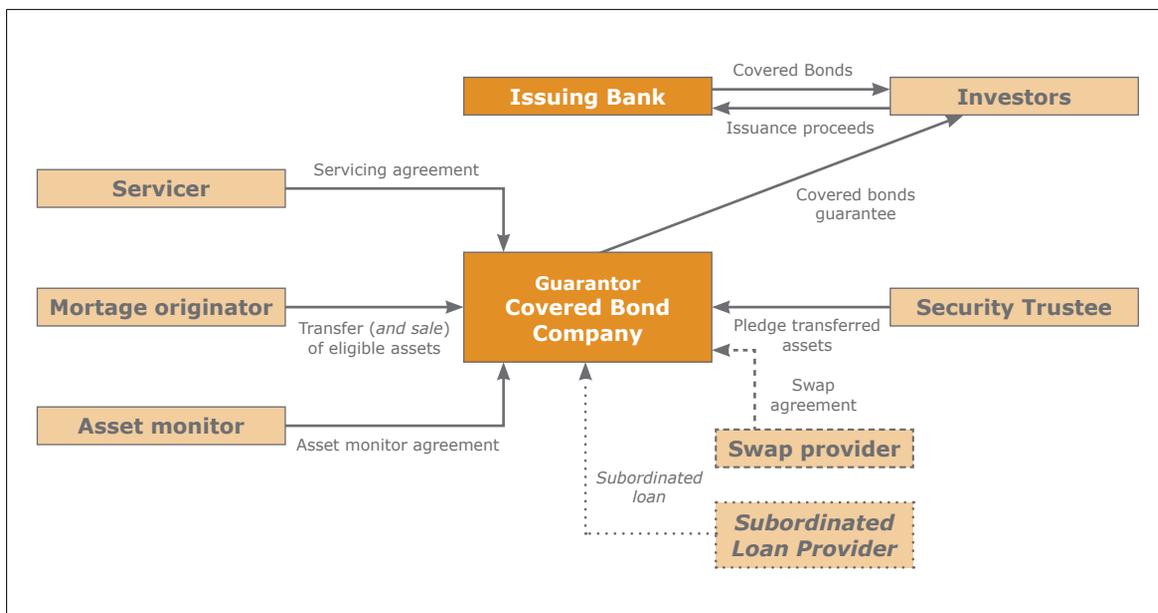
- > The Amendment Act Financial Markets of 19 November 2014, published on 5 December 2014;¹
- > The Amendment Decree Financial Markets 2015 of 28 November 2014, published on 19 December 2014;²
- > The Ministerial Regulation amending the Regulation Implementing the Financial Supervision Act on Registered Covered Bonds of 9 December 2014, published on 17 December 2014.³

The new regulatory regime came into force on 1 January 2015 per Decree 534 of 11 December 2014. Dutch registered covered bond issuers have to comply with all requirements since 1 January 2016.

II. STRUCTURE OF THE ISSUER

Dutch registered covered bonds can be issued by licensed banks that are located in the Netherlands. The issuing bank has to apply for registration with the Dutch Central Bank, which in turn decides to include a) the issuing entity and b) the category of covered bonds (to be) issued in a *public register*.

> FIGURE 1: STRUCTURAL OVERVIEW



1 Wijzigingswet financiële markten 2015, nr 472.

2 Wijzigingsbesluit financiële markten 2015, nr 524.

3 Wijziging van de Uitvoeringsregeling Wft ter zake geregistreerde gedekte obligaties, FM 2014/1900 M.

To be registered, the bank needs to prove that, in the case of a default of the issuer, the covered bondholders have a priority claim over the eligible assets securing coupon and redemption payments due on the registered covered bonds. In practice this means that the issuer has to provide evidence that the cover assets are secured in favour of the covered bondholders via the transfer to a separate legal entity, the Covered Bond Company (CBC). The issuer has to deliver to the supervisor an independent legal opinion confirming this.

The Covered Bond Company is established exclusively to isolate the cover assets from the other assets of the bank and to perform the necessary activities for the registered covered bonds. It can, but is not obliged to, give a right of lien over the cover assets to another separate legal entity (the Security Trustee), that represents the interests of the covered bondholders. In practice, Dutch covered bond programmes do provide for such a pledge of the transferred assets to a Security Trustee.

The Covered Bond Company can also enter into agreements for the administration and management of the cover assets, as well as for liquidity and risk management purposes. These include derivative contracts, servicer agreements, asset monitor agreements and management agreements. The Covered Bond Company is not permitted to take actions resulting in payment obligations ranking equal or senior to the covered bondholders, unless these are related to the management, risk management, payment and administration of the registered covered bonds and the cover assets.

III. SEGREGATION OF COVER ASSETS AND BANKRUPTCY REMOTENESS OF COVERED BONDS

In order to secure the cover assets in favour of the covered bondholders, the assets are transferred to a separate legal entity, the Covered Bond Company, by means of a guarantee support agreement. Under this agreement, the mortgage originator passes on eligible receivables to the Covered Bond Company via an undisclosed or silent assignment. The legal ownership of the mortgage loans is transferred to the Covered Bond Company via a deed of *assignment*, or a deed of *sale and assignment* with the tax authorities, without notifying the borrowers.

The Covered Bond Company guarantees in return to pay interest and principal on the covered bonds to the investors if the issuer defaults (covered bond guarantee). The obligations of the Covered Bond Company are unsubordinated and unguaranteed obligations, secured indirectly through a parallel debt, by a pledge of the transferred assets by the Covered Bond Company to the Security Trustee.

If the issuer defaults on his obligations, the Security Trustee may serve an issuer acceleration notice to the issuer and a notice to pay to the Covered Bond Company in line with the guarantee. As such the covered bonds do not accelerate if the issuer defaults, while the bondholders have full recourse to the assets of the Covered Bond Company. If the Covered Bond Company defaults on its payment obligations the covered bonds may accelerate (hard and soft bullet covered bonds) or may become pass-through conditional on pool sales being unsuccessful and a breach of the amortisation test (conditional pass-through covered bonds).

To ensure the bankruptcy remoteness of the Covered Bond Company, the issuing bank or other group entities are not allowed to hold shares in, or have control over, this legal entity. Furthermore, to assure continuity of the management of the cover assets by the Covered Bond Company post issuer default, the bank has to submit to the supervisor, upon registration, a plan for the management of the cover assets in the event of an issuer default (Post Issuer Default Plan). This plan describes the operational procedures and internal controls related to the programme if the issuer can no longer manage the assets, including the circumstances leading to a transfer of the management tasks to the Covered Bond Company. This plan is set up by the issuer and discussed with the supervisor, but it will not be published.

IV. REGISTRATION REQUIREMENTS AND COVER ASSETS

At the time of registration of a covered bond programme at the Dutch Central Bank, the issuing entity has to indicate the specific features of the covered bond programme. This includes a wide range of conditions, such as the maximum size of the programme, the rights and obligations of the Covered Bond Company, the rights

and obligations of the holders of the covered bonds, the type of cover assets, as well as various risk management procedures. In any case, the issuing entity needs to provide information about the following features:

- > The redemption profile of the covered bonds, i.e. whether the covered bonds have a hard bullet, soft bullet, or (conditional) pass-through structure. The Dutch law allows issuance from a single programme of covered bonds with a hard bullet structure as well as those with a soft bullet structure with an extension period up to 24 months. In contrast, conditional pass-through covered bonds need to be issued from a separate programme.

The covered bond programmes of ABN AMRO Bank and ING Bank contain mainly soft-bullet issues. Some covered bonds that have been privately placed (including some denominated in foreign currencies) still have hard bullet structures. Meanwhile, Rabobank and de Volksbank only have soft bullet covered bonds outstanding, while the covered bonds issued by Achmea Bank, Aegon Bank, F. van Lanschot Bankiers, NIBC Bank and NN Bank all have conditional pass-through structures.

- > The specific nature of the cover pool assets. Public loans, residential mortgages, commercial mortgages, and shipping loans, all qualify as cover assets. Only residential mortgages and commercial mortgages can be combined in a single programme. Currently, all Dutch covered bond programmes are backed by Dutch residential mortgages only.
- > The country exposure of the cover assets as well as the law by which they are regulated. Currently, all cover assets fall under Dutch law.

The Dutch Covered Bond Law further stipulates that each issuer will make sure the above-mentioned features will be satisfied during the entire lifetime of the covered bond transaction, so that all covered bonds issued from the same programme have the same features. This is both to protect investors as well as to enhance transparency.

Primary cover assets

The cover assets should meet the CRR Article 129 requirements, implying that the followings assets are eligible:

- > Exposures to or guaranteed by central governments, central banks, public sector entities, regional governments, local authorities, multilateral development banks, international organisations as referred to in article 129 CRR, paragraph 1(a) and (b);
- > Residential mortgages up to a 80% LTV ratio;
- > Commercial mortgages up to a 60% LTV ratio;
- > Ship loans up to a 60% LTV ratio;
- > Other assets that can be made eligible under a Ministerial Regulation.

In the Netherlands, only one type of primary cover assets can be used as collateral for a specific covered bond programme, except for residential mortgages and commercial mortgages. Residential and commercial mortgages can be used as collateral in a single programme, but only in a predefined mix (that is not allowed to change during the life of the transaction). Securitisation notes are not eligible as collateral. To avoid confusion, Dutch mortgage loans carrying a guarantee from the government-sponsored Nationale Hypotheek Garantie (NHG) scheme, are treated as normal residential mortgages in all current Dutch covered bond programmes, subject to an 80% LTV cut-off for asset coverage requirement purposes.

Substitute cover assets

The Dutch Covered Bond Law also allows for substitution assets to be included as cover assets. However, the inclusion of these type of assets is restricted to a maximum of 20% of the outstanding covered bonds. Eligible as substitution assets are public sector exposures and exposures to institutions as referred to in the CRR Arti-

cle 129 (1a, b, c). Furthermore, exposures that are explicitly permitted by the Dutch Central Bank as referred to in CRR Article 129 (paragraph 1, third sub-paragraph) will also be allowed.

Country exposure of cover asset

The law notes that the debtor of the cover asset as well as the collateral related to the cover assets are located in the EU, the European Economic Area, or, as assessed by the European Commission, in a country with prudential supervisory as well as regulatory requirements that are at least equivalent to those in the EU. Currently, cover assets backing Dutch covered bond programmes exclusively consist of Dutch residential mortgages.

Assets that are not allowed

Certain types of assets are not allowed as cover assets, such as impaired loans referred to in CRR Article 178, assets to which a specific legal claim is attached that supersedes the ownership entitlement of the owner of the assets, or exposures of owners of the cover assets to the issuing bank or entities of the same group (such as deposits).

V. VALUATION AND LTV CRITERIA

Loans backed by immovable property, such as residential and commercial mortgages, should meet the (valuation) requirements set out in CRR Article 208 and 229 (1), which includes, among others, legal enforceability as well as sound underwriting criteria. This CRR articles also state that the value of the property should be valued by an independent valuation agent on an annual basis for commercial properties, and every three years for residential properties. The Dutch Covered Bond Law is a bit more strict and prescribes that the valuation has to be updated every year. The supervisor can even request a more frequent valuation if it sees a need to do so, for example during times of sharp house price declines.

The value of Dutch property is based on the market value. Most covered bond issuers take a prudent approach when adjusting the value of the properties that are included in the cover pools. For example: all issuers take fully into account any house price decreases, while most issuers adjust for house price increases only partially. Indexation takes place on a monthly basis by means of the house price average in the Netherlands according to the Kadaster house price index or other recognised methods.

In order to comply with the CRR requirements, residential mortgages with a LTV higher than 80% will only be recognised up to an 80% LTV (60% LTV for commercial mortgages). In a situation where mortgages with an LTV of higher than 80% are included in the cover pool, this mortgage loan will only count for a maximum of 80% in the asset cover test. The difference between the actual (higher) LTV and the 80% maximum will serve as an extra credit enhancement.

A large part of the Dutch mortgages tend to exceed the 80% LTV level, although the LTV criteria for newly originated mortgages have become more prudent in recent years. As of 2018, the maximum statutory LTV limit is 100%. The high-LTV ratios in the Netherlands are mainly a result of the fiscal treatment of home ownership (tax deductibility of interest payments).

No Loan-to-Income (LTI) thresholds are applicable in the Dutch covered bond regulations or programmes, but since 2013, all new Dutch mortgages have been subject to strict statutory LTI maximums at origination.

VI. ASSET – LIABILITY MANAGEMENT

Asset coverage requirements

The Dutch Covered Bond Law provides for two distinct asset coverage requirements:

- > The total value of the cover assets (using the actual outstanding loan amount) always has to be equal to at least 105% of the nominal value of the outstanding registered covered bonds.

- > The total value of the cover assets (using the CRR LTV cut-off percentages) always has to be equal to at least 100% of the nominal value of the outstanding registered covered bonds.

For the purpose of the calculation of these over collateralisation tests the primary cover assets are recognised at their nominal value and substitute cover assets at their market value. Banks typically commit contractually to higher overcollateralisation levels under the asset cover test for, amongst others, rating agency purposes.

Liquidity coverage requirements

Issuers, furthermore, need to ensure that the Covered Bond Company always maintains sufficient liquid assets or generates sufficient liquidity via the cover assets to fulfil the *coupon and redemption obligations* on the covered bonds over a period of six months, including other obligations ranking senior to the covered bondholders (legal liquidity coverage requirements). The liquidity buffer requirement with respect to *redemption payments* is not applicable for covered bonds with maturity extension periods of more than six months (soft-bullet or conditional pass-through). Cash flows from derivatives contracts related to the covered bond liabilities are also taken into consideration.

The legal liquidity coverage requirements differ from the contractual liquidity coverage requirements. An example of this is the contractual *pre-maturity test* applied by Dutch issuers with regard to the redemptions of hard bullet covered bonds. This pre-maturity test is subject to issuer rating triggers and a test period of twelve months. Dutch issuers furthermore contractually commit to cover at least three months of interest expenses on the covered bonds by means of a *reserve fund* or a *reserve accounts*. In practice the legal liquidity coverage requirements overlap with the contractual liquidity coverage requirements.

Risk management procedures

The issuing bank has to employ reliable and effective risk management procedures to assure that sufficient eligible primary cover assets and substitute assets are available at all times during the life of the registered covered bond to meet, amongst other things, all overcollateralisation and liquidity requirements.

The Covered Bond Company can only enter into derivative contracts (such as currency swaps, interest rate swaps and total return swaps) or other risk mitigating contracts, if these support the risk management of the programme in favour of the registered covered bondholders. The counterparty to these agreements should not have the right to terminate the contract or to suspend its obligations under the contract if the creditworthiness of the issuing bank deteriorates. If the counterparty itself no longer meets the minimum creditworthiness requirements, it should provide for sufficient collateral, a suitable third-party guarantee, or replace itself.

As a result of changes in especially the regulatory landscape the use of derivative contracts to mitigate (interest rate) risks associated with the registered covered bonds has diminished in importance in recent years. Instead, several issuers decided to introduce interest reserve requirements, minimum mortgage interest rate requirements and/or to pledge additional collateral.

Asset encumbrance restrictions

The Dutch Covered Bond Legislation provides for discretionary *soft asset encumbrance restrictions*. The Dutch Central Bank makes sure, on a case-by-case basis, that a healthy relationship is maintained between the nominal value of the registered covered bonds outstanding and the consolidated balance sheet total of the issuing bank (the so-called healthy ratio). The going-concern interests of the bank, in terms of stability and funding source efficiency, as well as the post-bankruptcy interests, including those of other unsecured creditors, are assessed. The issuance ceiling for covered bonds (the maximum amount of covered bonds than an issuer is allowed to have outstanding) is determined upon registration and is reviewed annually. The Dutch Central Bank can prohibit a bank from issuing any further registered covered bonds if it is of the opinion that the *healthy ratio* requirements are breached. The Central Bank can also decide to reject a request for registration on these grounds.

Stress testing

The issuer has to prepare stress tests on a regular basis for the Dutch Central Bank to show that there are sufficient primary cover assets available (i.e. unencumbered) on its balance sheet for replenishment purposes. Credit risk, interest rate risk, currency risk and liquidity risk all have to be considered, including the derivative contracts mitigating these risks. Other risks deemed relevant by the Dutch Central Bank, such as housing price shocks, must be considered as well. The stress tests related to these risks can also be performed on a combined basis.

VII. TRANSPARENCY

Before registration of its programme the covered bond issuer already needs to report a lot of detailed information to the supervisor on the specific features of the covered bond programme (see paragraph III). After registration, the Dutch Covered Bond Law stipulates that the issuing entity shows at least every quarter to the Dutch Central Bank that the programme still fulfils all requirements, while it shows on at least an annual basis that it has enough unencumbered primary cover assets available for replenishment purposes (under different stress scenarios). Issuers also provide the Dutch Central Bank with an annual report of the Covered Bond Company within six months after closing of the reporting year. Finally, issuers need to notify the Dutch Central Bank in advance of any (upcoming) significant changes the covered bond programme.

The Dutch law requires issuers to provide investors with the following information at least on a quarterly basis:

- > Information on the credit risk, market risk, exchange rate risk, interest rate risk, and liquidity risk related to the cover assets and the covered bonds;
- > The nominal value of the covered bonds outstanding;
- > The total value and composition of the cover pool, including the geographical distribution;
- > The ratio between the total value of the cover assets and the total nominal value of the covered bonds;
- > The ratio between the total value of the cover assets when applying the CRR requirements and the nominal value of the covered bonds;
- > The ratio between the total value of liquid assets and the upcoming interest payments (and redemptions if hard bullet structure) and other mandatory payments within the next six months;
- > The maturity structure of the cover assets as well as the covered bonds;
- > The percentage of cover assets in arrears (i.e. more than 90 days overdue); and
- > Information about the counterparties of the Covered Bond Company.

All Dutch registered covered bond issuers currently publish investor reports on a monthly basis. These reports can be found on their websites, while there is also a link on the website of the Dutch Association of Covered Bond Issuers (DACB) to these reports. The Dutch issuers have also implemented the Harmonised Transparency Template (HTT).

VIII. COVER POOL MONITOR AND BANKING SUPERVISION

The issuer has to appoint an asset monitor (which could be the issuing banks own external accountant) before its first issuance under a registered covered bond programme. At least once a year, the asset monitor has to check the asset coverage and liquidity coverage calculations. For as long as the issuing bank is capable of managing the cover assets, the asset monitor, randomly checks the files relating to the cover assets on an annual basis, including the valuation and administration of the assets, and reports its findings to the supervisor. These random checks can also be arranged separately with a different (not the issuing banks own) external accountant. The asset monitor agreement has to assure however that the asset monitor continues to perform its duties after an issuer event of default. To safeguard this, the Covered Bond Company will become a party

to the asset monitor agreement. The agreement can also stipulate explicitly that the obligations of the asset monitor will remain unaffected by the situation of the issuing bank.

Dutch registered covered bond programmes are furthermore subject to special supervision of the Dutch Central Bank. The Dutch Covered Bond Legislation gives substance to the special supervision via a set of strict requirements during the registration phase and post registration.

- > Upon registration, the issuing bank has to provide the Dutch Central Bank with a written statement by the board of directors that all the regulatory requirements are met regarding the asset segregation, asset coverage, liquidity coverage and risk management procedures. The bank furthermore has to demonstrate that it fulfils all legal requirements ensuring that the payment obligations due on the registered covered bonds are adequately secured. The bank has to specify the conditions applicable to the covered bonds, such as the redemption profile, the type of primary cover assets, whether the assets are CRR eligible, and the geographical location of the assets. The bank, additionally, has to demonstrate that it is able to meet the reporting obligations towards the Dutch Central Bank and the covered bondholders.
- > After registration, the issuer has to make sure that the registered covered bonds continue to meet the registration requirements. The Dutch Central Bank will confirm in the register whether a category of registered covered bonds meets the CRR Article 129 requirements. The CRR listing remains intact for as long as the covered bonds meet the requirements. A category of registered covered bonds cannot be deregistered, but the Dutch Central Bank can decide to *deregister the issuer*, if the issuer no longer complies with the regulatory requirements. The Dutch Central Bank can also impose a penalty or a fine if an issuer fails to meet its obligations. A deregistered issuer is not allowed to issue any new covered bonds.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

Dutch registered covered bonds are UCITS 52(4) compliant, while they also meet all current requirements of the CRR Article 129.⁴ So, they should be eligible for a 10% preferential risk weight treatment under the Standardized Approach. The bonds are also Solvency II and ECBC Label compliant. Furthermore, the currently outstanding Euro benchmark covered bonds fall within the Level 1 category of the LCR.

X. ADDITIONAL INFORMATION

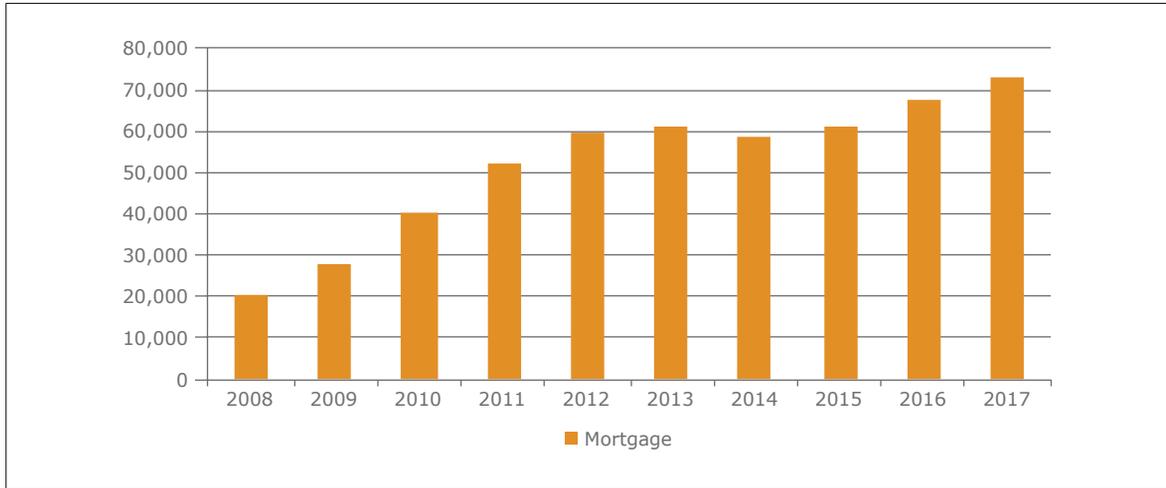
It is worthwhile noting that the update of the Dutch Covered Bond Law, effective as of 1 January 2015, has seen a convergence in the Dutch Covered Bond Legislation towards the best practices as proposed by the European Banking Authority, increasing transparency and investor protection. As a result, the Dutch regulatory framework is well positioned in terms of amendments required to align the law with the European Commission's March 2018 proposals for a Covered Bond Directive and Regulation.

Finally, more information on Dutch covered bonds can be found on the website of the Dutch Association of Covered Bond Issuers (www.dacb.nl), which was established in 2011 and has the following objectives:

- > To represent the interests of the Dutch issuers in discussions with legislative and regulatory authorities;
- > To provide investors with information about the Dutch covered bond market;
- > To participate on behalf of the Dutch issuers in international covered bond organisations like the ECBC;
- > To continuously improve the quality of the Dutch covered bond product offering.

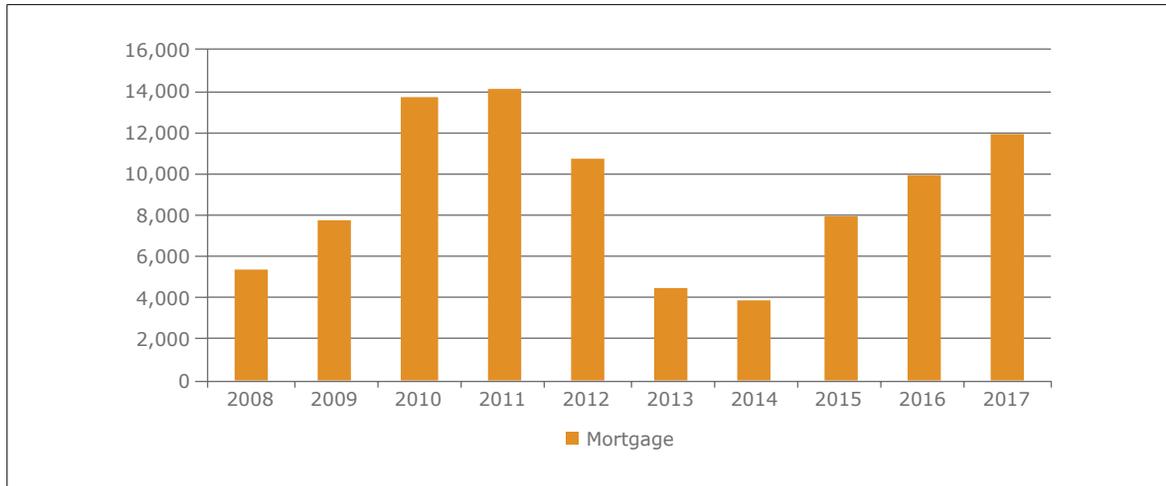
⁴ Please click on the following link for further information on the UCITS Directive and the Capital Requirements Regulation (CRR): <https://hypoc.org/ecbc/covered-bonds/>.

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



Source: EMF-ECBC

> FIGURE 3: COVERED BONDS ISSUANCE, 2008-2017, EUR M



Source: EMF-ECBC

Issuers: ABN AMRO Bank, Achmea Bank, Aegon Bank, F. van Lanschot Bankiers, ING Bank, NIBC Bank, NN Bank, Rabobank and de Volksbank.

ECBC Covered Bond Comparative Database: http://www.ecbc.eu/framework/65/Dutch_registered_CBs_programmes.



COVERED BOND LABEL: ING Bank N.V. (2 pools), ABN AMRO Bank N.V. (1 pool), de Volksbank N.V. (1 pool), NIBC Bank N.V. (1 pool), F. van Lanschot Bankiers NV (1 pool), Aegon Bank N.V. (1 pool), Coöperatieve Rabobank U.A. (1 bank), Nationale-Nederlanden Bank N.V. (1 pool), Achmea Bank N.V. (1 pool).