

Finansinspektionen's Regulations

Publisher: Gent Jansson, Finansinspektionen, Box 6750, 113 85 Stockholm.
Ordering address: Thomson Fakta AB, Box 6430, 113 82 Stockholm. Tel. +46 8-587 671 00, Fax +46 8-587 671 71.
Subscribe also by e-mail at www.fi.se.
ISSN 1102-7460

Finansinspektionen's (the Swedish Financial Supervisory Authority) Regulations and General Guidelines Governing Covered Bonds;

FFFS 2004:11
Published
1 October 2004

decided 21 September 2004.

Finansinspektionen hereby prescribes the following pursuant to section 1 of the Covered Bonds (Issuance) Ordinance (2004:332).

Finansinspektionen hereby issues general guidelines pursuant to the provisions broken down into sections.

Chapter 1. Scope and definitions

1 § These regulations and general guidelines contain provisions regarding the issuance of covered bonds. The regulations shall be applied by the following undertakings:

- Swedish banks and credit market undertakings which apply for a licence to issue covered bonds; and
- Swedish banks and credit market undertakings which have received a licence from Finansinspektionen to issue covered bonds.

2 § For the purposes of these regulations and general guidelines:

1. *the Act*: means the Covered Bonds (Issuance) Act (2003:1223);
2. *cover pool*: means that which is set forth in Chapter 1, section 2 of the Act.

Chapter 2. Conditions for licences

1 § An undertaking shall in connection with an application for a licence to issue covered bonds submit the following documents to Finansinspektionen:

1. A copy of the minutes of the board of directors meeting evidencing that the board of directors has resolved to apply for a licence;
2. A description of the planned business indicating the undertaking's handling of covered bonds and cover pools;
3. A separate plan in accordance with the provisions set forth in Chapter 2, section 1, subsection 3 of the Act, or a description that the conversion has taken place;
4. A financial plan for the next three financial years indicating that the undertaking's financial status is sufficiently stable that the interests of other creditors will not be jeopardised in the event that the company issues covered bonds;

5. A description of the manner in which the covered bonds business shall be organised in order that sound internal supervision may be achieved with respect thereto;
6. Information regarding IT systems which will be used in the planned business.

Chapter 3. Cover pool requirements

Permitted mortgage loans

1 § In order to qualify as a mortgage loan, the loan must be secured in the form of a mortgage on real property, site-leasehold rights, or tenant-owner rights. The mortgaged property shall primarily be intended for one or more of the following purposes: residential, agricultural, or commercial operations.

2 § When determining the maximum loan-value ratio pursuant to Chapter 3, section 3 of the Act, 75 per cent of the loan-value ratio may be used only where the mortgaged property is primarily intended for residential purposes. In other cases, the loan limitations of 70 or 60 per cent shall apply as set forth in the stated provisions.

General guidelines

In order to determine the purpose for which mortgaged property is primarily intended, guidance may be obtained from the type codes which are set forth in assessment information in the land register.

Where a property covers several assessment units, the primary use may be determined with the assistance of sub-values in the tax assessment value.

3 § In order for mortgage loans to be included in the cover pool, buildings which are appurtenant to the property and site-leaseholds must be insured against fire.

4 § Where a loan claim included in the cover pool remains unsettled after 60 days, its value may not be included in the cover pool's value in connection with the assessments to be made in accordance with Chapter 3, sections 8 and 9 of the Act.

The manner in which the valuation shall be carried out

5 § The appraiser who shall carry out an individual valuation in accordance with Chapter 3, section 5 of the Act shall possess sufficient theoretical and practical experience regarding the manner in which the valuation shall be carried out and otherwise be well acquainted with the general and local property market.

6 § In connection with the valuation, recognised and accepted valuation methods shall be used.

General guidelines

Supporting documentation for valuations which are based on general price levels should be documented.

The manner in which the verification of the market value shall be carried out

7 § An issuing institution shall regularly monitor property price trends at the localities or in the regions in which the institution issues loans. In the event of declining price levels, the institution shall verify that a property, which constitutes collateral for issued loans, maintains the same value as at the time of the original or latest valuation. Where the market conditions at the locality or in the region have seriously declined, the valuation shall be reviewed.

Chapter 4. Conditions for derivative agreements and calculation of, and terms and conditions for, risk exposure and interest payments

General guidelines

Matching rules

The basic rule for the covered bonds system is that the cover pool must exceed the liabilities in respect of the outstanding covered bonds at all times. The matching rule set forth in Chapter 3, section 8 of the Act is aimed at the current asset and liability values, whilst Chapter 3, section 9 of the same Act is aimed at the present value calculation of future cash flows and stability, in light of changes in interest rates and exchange rates.

Thus, where the Act refers in Chapter 3, section 8 to the nominal value of the cover pool and of the covered bonds, this should be understood to mean the current asset and liability values taking into consideration any differences in exchange rates and the effect of any derivative agreements.

The following examples elucidate the foregoing:

- Where the covered bonds include bonds which have been issued at a premium, the current liability book value should form the basis of the matching calculation;
- Where the substitute collateral includes, e.g. bonds which have been acquired at a discount, the current asset book value should form the basis of the matching calculation;
- Where the issuing institution has entered into derivative agreements in order to exchange currency for a certain volume of the covered bonds, the current value of such bond volume should be calculated taking into consideration the effect of the derivative agreement.

Present value calculation

1 § The present value of the assets in the cover pool must, upon a daily calculation, exceed the present value of the liabilities which relate to the covered bonds. In connection with the calculation, the present value of derivative agreements shall also be included. The discount factors (normally zero-coupon rates) which are used shall be such as may be derived from the swap rate curve for the relevant currency or another rate curve which is generally used for defining the interest rate on the respective market.

Interest rate risks

2 § The requirement in accordance with section 1 shall also be fulfilled after the following assumed interest rate changes:

- a sudden and sustained parallel shift in the swap rate curve, or another rate curve in accordance with section 1, by one percentage point upward;
- a sudden and sustained parallel shift in the swap rate curve, or another rate curve in accordance with section 1, by one percentage point downward.

General guidelines

In addition to the present value calculations, the issuing institution should also regularly perform other calculations relevant for the institution which are based on assumed sudden and sustained interest rate changes. In such calculations, the institution may, for example, perform calculations based on assumptions of sudden and sustained twists in the swap rate curve.

Currency risks

3 § Where assets included in the issuing institution's cover pool are denominated in a different currency than the covered bonds, the following conditions shall be fulfilled. This provision applies provided that the currency risk has not been completely hedged.

Upon a daily calculation, the present value of the issuing institution's cover pool must exceed the present value of the liabilities which relate to the covered bonds in the event of a ten-per cent sudden and sustained change of the ratio between the currency of the bonds and the currency of the assets.

In connection with the calculation, the present value of derivative agreements shall also be included.

4 § The result of the daily calculations of the present value, interest rate risks, and currency risks shall be documented and stored in a secure manner for five years.

Conditions for derivative agreements and the separate account

5 § Derivative agreements which the issuing institution enters into for its risk management in accordance with the matching rules set forth in Chapter 3, sections 8–9 of the Act may only relate to covered bonds and assets in the cover pool.

6 § Derivative agreements may not be structured such that premature termination is automatically triggered in the event that the issuing institution is placed into insolvent liquidation or where such may be demanded by the counterparty.

7 § Counterparties to derivative agreements shall either belong to the categories set forth in Chapter 3, section 2 of the Act or possess a publicly recognised credit rating from a qualified credit rating institution upon entry into the agreement at a level not less than set forth in the table below.

A single credit rating which satisfies the minimum requirement is sufficient provided that there is no credit rating also from another institution which lies below

the minimum level. In such case, there must be at least two credit ratings from qualified institutions which satisfy the minimum requirement.

Credit rating institution	Lowest credit rating	
	Long term	Short term
Moody's	A3	P2
Standard & Poor's	A-	A2
Fitch	A-	F2

In the event that any of the credit rating institutions stated in the table changes the designations in its assessment scales or credit worthiness requirements in order to reach a certain credit rating, the lowest credit rating requirement shall be adjusted to a corresponding degree.

Derivative agreements which are entered into before the institution has commenced issuance of covered bonds and which are intended to cover risks associated with previously issued bonds or other comparable instruments of indebtedness which have been converted to covered bonds may, provided such converted instruments of indebtedness are still outstanding, also be used to fulfil the matching requirements which apply to the business notwithstanding that the requirement set forth in the first paragraph is not fulfilled.

General guidelines

The issuing institution should enter into agreements which, in the event that the counterparty's credit rating falls below the level stated in the table during the term of the derivative agreement, enable the institution to:

- demand supplementary collateral; or
- terminate the agreement and replace it with another agreement with a counterparty possessing an acceptable credit rating.

Another alternative may be for the counterparty to ensure that some other party with an acceptable credit rating guarantees its obligations under the relevant derivative agreements.

The separate account

A holder of covered bonds shall, in the event of the issuing institution being placed into insolvent liquidation, hold a right of priority to funds which are held at the institution and which derive from the cover pool or derivative agreements. Such additional funds shall be registered in the register set forth in Chapter 3, section 10 of the Act commencing on the date of placement into insolvent liquidation. This requirement did not apply previously.

Instead, Chapter 3, section 9, subsections 3–4 of the Act contain provisions whereby funds from the payment flows which are part of the business shall be kept separate from the issuing institution's other funds in a separate account. The types of funds involved will vary depending upon the manner in which the issuing institution chooses to organise its business. However, it is of crucial importance that the institution undertakes such measures in respect of systems and organisation that the purpose of these provisions may be met in a satisfactory manner.

Chapter 5. Obligation to maintain a register

Security requirements

1 § The register referred to in Chapter 3, section 10 of the Act must meet stringent standards in respect of security against damage caused by fire or other causes.

The manner in which the register shall be maintained

2 § The information relating to the covered bonds and derivative agreements which shall be included in the register pursuant to Chapter 3, section 11 of the Act must be entered in the register not later than on the starting date of the agreements. Information which shall be included in the register which relates to loans and substitute collateral must be entered in the register on the day from which the relevant loan or substitute collateral are included in the cover pool. Thereafter, all information which relates to repayment instalment, current interest rates and terms and condition periods shall be updated on a daily basis.

3 § In the event that a mortgage loan is covered by collateral which is not within the loan limitations set forth in the Act, information regarding the amount by which the loan may be credited to the cover pool shall be entered in the register.

4 § Where the market value of property which constitutes collateral for a mortgage loan has been reduced such that a new, lower value must be determined in accordance with Chapter 3, section 7 of the Act, the new value must be entered in the register as soon as possible. Consequently, the maximum amount by which the loan may be applied to the cover pool shall be reduced.

5 § All information contained in the register must be capable of being verified.

Accessibility

6 § The issuing institutions shall ensure that the register is accessible to Finansinspektionen and the independent inspector from time to time.

Chapter 6. The independent inspector

Competence requirements

1 § The independent inspector shall be an external person possessing appropriate qualifications. The inspector may not undertake other engagements at the issuing institution or in other undertakings within the group of which the institution is a part other than to function as an independent inspector.

The inspector's duties

2 § The independent inspector shall monitor that the register is maintained in a correct manner and shall thereupon particularly verify that:

1. bonds and derivate agreements are registered in an accurate manner;

2. only loans and substitute collateral which fulfil qualification requirements are provided to the cover pool and that they are registered in an accurate manner;
3. the valuations of the underlying collateral are in accordance with the provisions of the Act and these regulations regarding the manner in which a valuation shall be carried out;
4. mortgage loans whose underlying collateral has diminished significantly in value in connection with the matching are only included in the cover pool at an amount which is within the new reduced loan limitations; and that
5. the matching rules are complied with.

Reporting obligations

3 § The independent inspector shall annually provide Finansinspektionen with a report of the inspection, and send a copy of the report to the auditor who is appointed by the authority.

4 § In addition, the inspector shall notify Finansinspektionen as soon as the inspector learns of any event which may be of significance for the authority in its supervision of the institution.

5 § The annual report shall contain:

1. an overall report of the manner in which the inspection work has been organised and performed;
2. a report of observations made with respect to the issuing institution's business regarding covered bonds; and
3. information regarding the number of hours and a breakdown of the principal work and the fees charged therefor; the latter mentioned information may also be provided separately.

These regulations and general guidelines shall enter into force on 15 October 2004.

INGRID BONDE

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