

3.38 SWEDEN

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I. FRAMEWORK

In Sweden, the issuance of covered bonds is governed by the Swedish Covered Bonds Issuance Act ('CBIA'), which came into force on 1 July 2004¹ and has been revised a couple of times, lastly this summer with the regulation required by the Covered Bond Directive (CBD). The CBIA prevails over the general bankruptcy regulation and grants covered bond investors a priority claim on the eligible cover assets. A regulation and guidelines from Finansinspektionen, the Swedish Financial Supervisory Authority ('SFS'), complement the legislation². In the SFS regulation and guidelines, some detailed criteria are specified regarding authorisation to issue covered bonds, cover pool requirements, coverage requirements and the cover register. The regulation has been revised to implement some parts of the CBD.

II. STRUCTURE OF THE ISSUER

The CBIA allows for all banks and credit institutions to issue covered bonds, provided that they have obtained a special authorisation from the SFS. The issuer has to meet certain criteria to qualify for the authorisation. These criteria include the submission of a financial plan showing the issuer's financial stability for the coming three years, the conversion of any outstanding mortgage bonds into covered bonds and the conduct of business in compliance with the CBIA. The SFS has the right to withdraw the authorisation should the institution be in material breach of the CBIA or have failed to issue covered bonds within one year of receiving the authorisation (Figure 1). If the SFS withdraws an authorisation, the SFS may lay down a plan to wind down the operation.

> FIGURE 1: AUTHORISATION REQUIRED TO ISSUE COVERED BONDS

Requirements for authorisation to issue covered bonds:

- > The institution's articles of association, by laws or regulations must comply with the CBIA.
- > The issuer must conduct the covered bonds business according to the CBIA and related regulatory provisions.
- > Any outstanding mortgage bonds must be converted into covered bonds or administered in an equivalent manner with respect to the creditors.
- > A financial plan for the next three fiscal years, confirmed by auditors, showing that the issuer is sufficiently stable and that the interest of other creditors is not jeopardised when it issues covered bonds.
- > The issuers have to submit an operational plan that shows sound management and supervision of the covered bond business (including information on the IT operations).

The SFS may withdraw an authorisation if:

- > The institution is in material breach of its obligations pursuant to the CBIA; and/or
- > The institution has failed to issue any covered bonds within one year of receiving the authorisation.

Source: Lag 2003:1223, FFFS 2013:01

The cover assets correspond to the covered bond investors claims on the issuer and remain on the balance sheet, i.e. there is no transfer of the cover assets to a separate legal entity. The covered bonds are direct, unconditional obligations on the part of the issuer. The cover pool is dynamic, and the outstanding covered bonds are secured by the whole cover pool; the individual cover bonds are not linked to any specific cover assets.

1 Lag (2003:1223) om utgivning av säkerställda obligationer (the Covered Bonds Issuance Act).

2 FFFS 2013:01 Finansinspektionen's Regulations and Guidelines regarding covered bonds.

In the event of insolvency of the issuer, the cover pool is bankruptcy-remote and not included in the general insolvency estate of the issuer but is exclusively available to meet outstanding claims of covered bond holders. Moreover, covered bond investors enjoy ultimate recourse to the insolvency estate of the issuer, ranking *pari passu* with senior unsecured investors.

III. COVER ASSETS

Eligible cover assets are mortgage loans, loans to the public sector and exposures to credit institutions. There is no requirement for separate cover pools for mortgage and public sector cover assets; both asset classes can be mixed in a single cover pool. However, most of the cover assets are mortgages (more than 95% of the assets in the cover pools).

For mortgagees to be eligible as cover assets they should be secured by:

- > real property intended for residential or commercial use;
- > site-leasehold rights intended for residential or commercial use;
- > a pledge against tenant-owner rights; or
- > similar foreign collateral (EEA).

Mortgages to commercial property are limited to 10% of the total value of the cover pool. If the purpose of the commercial property is agriculture this limitation is not valid. The collateral for the mortgage loans has to be located in Sweden or the European Economic Area (EEA). Neither asset-backed nor mortgage-backed securities are eligible as cover assets. The mortgage loans have to meet valuation criteria and certain loan-to-value ratios specified in the CBIA and the SFSA regulation (see section IV).

Eligible public sector assets are securities and other claims according to Capital Requirement Regulation (CRR) article 129(1) point (a) and (b).

Cover assets can also be exposures to credit institutions according to CRR article 129(1) point (c) that fulfil credit quality step 1 or 2. If the asset just fulfil credit quality step 3 an approval from the SFSA is needed. Assets that fulfil the requirement for the liquidity buffer are also allowed.

Non-performing loans due over 60 days cannot be included for the purpose of meeting the matching requirements set forth in the CBIA.

Derivative contracts

The CBIA provides for the use of derivatives for hedging of interest and currency risk. The derivatives must be structured so that an early termination is not triggered by an issuer default or on the counterparty's demand. The law stipulates asymmetrical collateralisation. Collateral, a guarantee or replacement language is required from the counterparty in the event of the rating falling below the minimum rating level. There are no reciprocal requirements on the covered bond issuer, but the derivative counterparty has a priority claim on the cover pool. The derivative contracts are included in the net present value coverage calculation, the purpose of which is to ascertain a good balance between the value of the assets and the liabilities in the covered bond programme.

IV. VALUATION AND LTV CRITERIA

The principles for the valuation of collateral for the mortgages in the cover pool are specified in the CBIA. The valuation relating to residential properties may be based on general price levels. The value of any other eligible property class must be based on the market price and determined on an individual basis by qualified professionals. The market value should reflect the price achievable through a commercial sale, without time pressure and excluding any speculative or temporary elements. Issuers are required to monitor the market value of the property in line with CRR article 129(3), and in the case of a significant decline review the valua-

tion and ensure that the loan to value (LTV) of the related mortgage loan remains within the limits. The valuer can be an employee of the issuer or external.

For the various mortgage types eligible as cover, the following maximum LTV ratios apply:

- > 80% of the value for real estate, site-leasehold rights and tenant-owner rights where the property is intended for residential use;
- > 60% of the value for real estate, site-leasehold rights and tenant-owner rights where the property is intended for commercial use, which may be exceeded up to a maximum level of 70% if all conditions prescribed in CRR article 129(1) point (f) are met.

The LTV limits are relative, not absolute. A loan with a higher LTV ratio can be included in the cover pool up to the legal threshold. The balance is refinanced through other funding instruments.

The issuer is required to test and analyse how changes in property values may affect LTV ratios and the value of the cover pool at least once a year. The tests should be based on conservative assumptions.

V. ASSET – LIABILITY MANAGEMENT

The CBIA requires the nominal value of the cover assets to at all times be at least 102 percent of the aggregate nominal value of claims arising from outstanding covered bonds. The cover assets, including derivatives, should, on a net present value basis, always be at least 102 percent of the corresponding net present value of outstanding covered bonds, taking into account the effects of stress-test scenarios on interest and currency risks set by the SFSA. The stressed scenario that should be tested regarding interest-rate risk is a sudden and sustained parallel shift in the reference swap curve by 100 bps in an unfavourable direction, and a twist in the swap curve. The currency risk should be tested for a 10% sudden and sustained change in the relevant foreign exchange rate for the currency of the covered bonds and the currency of cover assets. There is a minimum overcollateralisation (OC) requirement of two percent. Both the statutory OC and any additional OC for structural enhancement purposes are bankruptcy-remote and protected in the event of issuer insolvency.

The issuer shall ensure that the cash flow with respect to the assets in the cover pool, any derivative agreements and the covered bonds are such that the issuer is always able to meet its payment obligations towards the bondholders and derivative counterparties. The issuer should be able to account for these funds in the register.

VI. LIQUIDITY RISK

The issuer must cover at any time the cumulative maximum net cash outflow for the next 180 days with a liquidity buffer. The issuer may hold assets defined as liquid under level 1 or 2A of the EU Liquidity Coverage Regulation or short-term exposures to credit institutions of credit quality step 1 or 2. Under certain conditions the SFSA can allow some specific other assets (level 2B and deposits from institutions CQS 3).

The issuer can use covered bonds with extendable maturity structures. The bonds can be extended after an approval by the SFSA, and such approval can only be achieved if the SFSA is convinced that the extension will prevent a default of the issuer. If the issuer uses extendable bonds, it is the latest of the maturities that is used to calculate the liquidity buffer.

VII. TRANSPARENCY

The issuers are required to disclose information regarding their cover pool and outstanding covered bonds every quarter in line with the requirement in CBD article 14. This is being done publishing the harmonized transparency template (HTT) and a national transparency template (NTT) on each issuer's website.

In addition to the publicly disclosed information, the issuers are required to give their respective cover pool inspector (see section VII) additional information, specified in the SFSA regulation, and do quarterly reporting to the SFSA.

VIII. COVER POOL MONITORING AND BANKING SUPERVISION

The covered bond issuers are subject to special supervision by the SFSA. The SFSA supervises the issuers' compliance with the CBIA and related regulatory provisions. If an issuer is in material breach of its obligations under the legal framework, the SFSA can issue a warning or revoke the authorisation to issue covered bonds altogether. The SFSA may also revoke an authorisation if the issuer waives the license or if the institution has failed to issue covered bonds within a year from the date of the authorisation.

For each issuer, the SFSA appoints an independent and suitably qualified cover pool inspector (cover pool trustee), who is remunerated by the covered bond issuer. The duties of the cover pool inspector are to monitor the register and verify that the covered bonds, the derivative agreements, and the cover assets are correctly recorded. The inspector also ensures compliance with calculation of coverage and market risk limits in accordance with the framework. The inspector is also required to monitor the revaluations of underlying collateral that has been conducted during the year. The issuer is obliged to provide the covered bond inspector with any information requested relating to its covered bond operations. The inspector submits a report of his or her assessment to the SFSA on an annual basis and is required to notify the SFSA as soon as he or she learns about an event deemed to be significant.

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

Cover register

The issuer is required to keep a register of the eligible assets in cover pool, derivative contracts, and outstanding covered bonds. The law specifies the form and content of the register, which shall be easily accessible for the SFSA and the cover pool inspector. The registration ensures that the covered bondholders and derivative counterparties have a legally enforceable priority claim on the cover pool in the event of issuer insolvency. Prior to an issuer being declared insolvent, cash flows accruing from the cover assets must be accounted for in the register by the issuer. In the event of issuer default, covered bond investors and derivative counterparties have the same priority claim on such cash flows as they have on the cover pool. Any cash flows accruing from the cover assets after issuer insolvency should also be recorded in the cover pool register.

Issuer insolvency

In the event of issuer insolvency, the registered cover assets, registered derivatives and the covered bonds are segregated from the general insolvency estate. Covered bonds are not accelerated as long as the cover pool fulfils the requirements set out in the CBIA, which also allows for "temporary, minor deviations"³. An issuer default does not trigger early termination of any registered derivative contracts. Covered bond holders and registered derivative counterparties have a priority claim on the cover pool and cash that derives from the pool, ensuring timely repayment to original agreed terms, as long as the cover pool is compliant with the CBIA. The cover pool does however not constitute a separate legal estate. According to a legal opinion, the bankruptcy of the issuer should not lead to a debt moratorium on the covered bonds.⁴

Under the Swedish Bankruptcy Code, the insolvency of a parent company does not automatically trigger the insolvency of its subsidiary.

Cover pool default and preferential treatment

In the event of the cover pool being noncompliant with the eligibility criteria, the covered bonds would be accelerated. Covered bond investors and derivative counterparties would have a priority claim on the proceeds

³ According to the legislative history of the Act, this would be, for example, "temporary liquidity constraints".

⁴ There are no means in the Act that could disrupt or delay payment to covered bondholders. However, the Act does not explicitly derogate from the general provision of the Code of Procedures 1948 or the Bankruptcy Act 1987, of which neither explicitly ensures the integrity of payments on covered bonds.

from the sale of the cover assets, ranking *pari passu* among themselves but prior to any other creditors. If the proceeds are insufficient to repay all liabilities on the outstanding covered bonds, covered bond investors and derivative counterparties would have an ultimate recourse to the insolvency estate of the issuer, ranking *pari passu* with senior unsecured investors.

Survival of OC

Any OC present in the cover pool at the time of the issuer's insolvency is bankruptcy-remote provided that it is recorded in the cover pool register. Full repayment of outstanding claims related to the covered bonds and registered derivatives is required before the cover assets would be available to satisfy any claims from unsecured creditors.

The law does not provide for the appointment of a special cover pool administrator. The receiver-in-bankruptcy represents the interests of both the covered bond investors and the unsecured investors. The receiver can use the OC to pay advance dividends to other creditors of the bankrupt issuer, if the pool contains more assets than necessary.⁵ If the cover assets later prove to be insufficient, these advance dividend payments can be reclaimed.

Access to liquidity in case of insolvency

In the cases of the issuer's insolvency, the law does not enable the receiver-in-bankruptcy to refinance maturing covered bonds by issuing new covered bonds. The receiver cannot substitute ordinary cover assets for other assets. However, the receiver can utilise available liquid assets included in the cover pool and is allowed to sell assets from the cover pool to create the necessary liquidity.

The receiver-in-bankruptcy also has a mandate to, on behalf of the bankruptcy estate enter into loan agreements and other contracts for the purpose of maintaining sufficient coverage and liquidity and managing the currency and interest rate risks. The receiver should only enter into agreements if, on the date of execution of the agreement, the agreement is deemed to be in the bondholders' and derivative counterparties' interest and if the assets in the cover pool are deemed to fulfil the legal requirements. When the receiver enters into an agreement, the counterparty has a claim on the bankruptcy estate that ranks ahead of the secured creditors and creditors with rights of priority.

X. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The Swedish covered bonds are compliant with CRR article 129 and CBD. Since the bonds are compliant with CRR article 129, the applicable risk-weight for the Swedish covered bonds will be ten percent for those banks that use the standard method. Because the CBIA require compliance with CRR article 129, the bonds can be labelled "European Covered Bond Premium" and "svensk säkerställd obligation".

Covered bonds issued in other jurisdictions enjoy the same preferential capital treatment in Sweden, subject to the relevant foreign supervisory authority having assigned the covered bonds preferential risk-weights (principle of mutual recognition).

The Swedish UCITS Act (Lag (2004:46) om värdepappersfonder) allows for Swedish UCITS to invest up to 25% of their assets in Swedish covered bonds, instead of the 5% generally applicable to other asset classes.

XI. ADDITIONAL INFORMATION

Issuing and trading of Swedish domestic covered bonds

Normally the Swedish covered bonds are registered at Nasdaq Stockholm (a Nasdaq Inc. subsidiary), although no actual bond trading takes place there. The base prospectuses used follow the standard of and are compli-

⁵ According to a legal opinion, the receiver-in-bankruptcy would have to take into account a substantial safety margin to ensure that the cover pool's integrity and compliance with the Act is not jeopardized, which would be difficult to prove unless outstanding covered bonds were due to mature imminently.

ant with the Prospectus Regulation and are approved by the SFSA. The normally used technique for issues is “on tap”.

To ensure a good market liquidity, the large issuers issue their bonds as benchmarks which in the Swedish market mean large issues (SEK 3 bn and more) and that a number of dealers show both bid and offer prices. Only benchmarks are deliverable in the future contracts. When a new benchmark bond is issued, the issuer makes sure that the amount issued meets the requirements for a benchmark sized deal. After the initial day of issuance, the issuer can, without further notice, issue “on tap” the size required to fund the lending. At the peak of the life of the bond it typically has a volume of SEK 50 to 70 bn. After that the volume decreases due to active repurchase operations by the issuer. With one year to go to maturity a loan is no longer of benchmark status. This paves the way for a controlled redemption of the remaining part of the loan.

The bonds are sold into the primary market through banks acting as agents for the issuer. These banks also act as market makers in the secondary market. Currently, there are five banks that act as market makers in covered bonds: Danske Bank, Nordea, SEB, Svenska Handelsbanken and Swedbank. The market for government and domestic covered bonds, as well as treasury bills, is a telephone and screen-based over-the-counter market. Market makers display indicative two-way prices on an electronic information system which is instantaneously relayed by Reuters. Fixed prices are quoted on request and most deals are concluded via telephone. Trading in the secondary market takes place on all business days between 09.00 and 16.15 (local time). The number of bonds to be quoted is regulated in an agreement between the issuer and the market-maker.

Bonds are quoted on a yield basis with bid and ask spreads of (under normal market conditions) 2 bp for the liquid benchmark bonds. The settlement day for bonds is three business days after the trading date. Treasury bills are quoted on a simple yield basis and are settled two business days after the trading day. The normal trading lot in government securities and liquid covered bonds is SEK 200-500 m.

Sweden has a liquid repo market with almost all banks and broker firms involved in the trading. The repo market in Sweden started in the late 1980s and developed fast. The Swedish Debt Office offers a repo-facility in government bonds and treasury bills and the covered bond issuers offer their market makers a repo-facility in their own covered bonds. The repo transactions are viewed as ‘sell-buy back’ or ‘buy-sell back’ deals and the ownership of the security must be transferred. There are no standard conditions for a repo transaction and the counterparties agree on maturity, settlement day and delivery for each deal. Mostly, repos are settled two banking days after the trading day. Repo rates are quoted as a spread vs the Riksbank repo rate. Because of quantitative easing there is currently a lack of government bonds in the repo market, which has negative effects on the functionality of the repo market.

Almost all publicly listed securities in Sweden are in book-entry form, registered and settled via Euroclear Sweden’s system. Domestic settlement requires a securities account or a custody account with one of the Swedish banks or investment firms. Foreign investors can either have a custodian service with a Swedish bank or investment firm or settle via Euroclear or Clearstream.

Accrued interest is calculated from the previous coupon date to the settlement date. The interest rate is calculated by using ISMA’s 30E/360-day count – “End-of-month” convention.

Swedish government bonds and covered bonds have five ex-coupon days, hence there is a negative yield when settlement occurs within five business days before the coupon date. Swedish krona bonds redeem at par upon maturity and most of them pay coupon annually. All domestic banks act as paying agents.

The ASCB

The Association of Swedish Covered Bond issuers (ASCB), which was established in 2009, performs ongoing work to further improve the conditions for the Swedish covered bond market. More information about the Swedish covered bond market can be found at www.ascb.se.

Essential terms and conditions of a typical Swedish market maker agreement

Typically, the larger issuers have 5-8 covered bond series with benchmark status. For the benchmark issues, the market maker typically has a duty to:

- > Help the issuer sell bonds via taps of the benchmark loans in the market;
- > Actively support trading of these bonds in the secondary market; and
- > Continuously quote indicative rates in the information systems used.

The obligations of a market maker are conditional upon a number of things, inter alia:

- > that no change in the economic, financial or political conditions, which in the reasonable opinion of the market maker would create a major obstacle to the fulfilment of the obligations, have occurred;
- > that the bonds, in the reasonable opinion of the market maker, cannot be placed in the primary or secondary market on normal market conditions.

If the obligations cannot be fulfilled, the market maker shall notify the issuer and may withdraw from the duties wholly or in part for a shorter or longer time.

The issuer has an obligation to, under normal market conditions, offer a limited repo facility in the outstanding benchmark bonds to the market maker.

Issuers: Stadshypotek, Swedbank Mortgage, Nordea Hypotek, Swedish Covered Bond Corporation (SCBC), SEB, Skandiabanken, Länsförsäkringar Hypotek, Landshypotek, Danske Hypotek, Bluestep Bank, Borgo and Sparbanken Skåne. The market is dominated by the first five of them and the majority of their exposure is to domestic residential mortgages, with the remainder consisting of commercial property loans and public-sector loans.



COVERED BOND LABEL: Länsförsäkringar Hypotek AB (1 pool), Skandinaviska Enskilda Banken AB (SEB) (1 pool), Stadshypotek AB (publ) (3 pools), Swedbank Mortgage AB (1 pool), The Swedish Covered Bond Corporation (1 pool), Nordea Hypotek (1 pool).

For the most up-to-date information, please consult the new ECBC Covered Bond Comparative Database webpage on the Covered Bond Label website www.coveredbondlabel.com.

In the context of the transposition of the Covered Bond Directive (the final deadline for which was 8 July 2022), the ECBC has undertaken a full review and update of the Covered Bond Comparative Database to take account of the latest regulatory developments. This unique reference tool can be accessed via the link hosted on the Covered Bond Label website (www.coveredbondlabel.com/legislation/comparative_database).

For further national information on the Swedish market, please see compare.coveredbondlabel.com/frameworks. To access the "Country Comparison" feature of the database, please see compare.coveredbondlabel.com/compare/select/frameworks.