

3.11 CZECHIA

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I. REGULATORY FRAMEWORK

The Czech legal and regulatory framework of covered bonds (the **Czech Covered Bonds Rules**) is laid down under Czech Act No. 190/2004 Coll., on Bonds, as amended (the **Czech Act on Bonds**), Czech Act No. 182/2006 Coll., on Insolvency and Methods of its Resolution (Insolvency Act), as amended (the **Czech Insolvency Act**) and certain other provisions of the applicable laws.

In May 2022, an amendment to the Czech Covered Bonds Rules (the **CBD Amendment**) entered into force. The CBD Amendment introduced some of the mandatory features of the Covered Bond Directive not yet present in the Czech Covered Bonds Rules as well as some of the optional features of it. Furthermore, the CBD Amendment introduced further changes (not relating to the CBD) aiming mainly to fill gaps in the Czech Covered Bonds Rules.

II. COVERED BONDS AND THEIR TYPES

The Czech Covered Bonds Rules recognise three types of covered bonds (*kryté dluhopisy*): (i) mortgage covered bonds (*hypoteční zástavní listy*); (ii) public covered bonds (*veřejnoprávní zástavní listy*); and (iii) mixed covered bonds (*smíšené zástavní listy*).

The distinction between these three types of covered bonds depends on what cover assets must prevail in the cover pool that serves as a cover in respect of those covered bonds and by virtue of which cover assets the applicable Statutory 85% Limit (as described below) must be complied with.

III. STRUCTURE OF THE ISSUER

Under the Czech Covered Bonds Rules, covered bonds may only be issued by a bank (a credit institution) that holds a Czech banking licence and that has its seat in Czechia.

The CBD Amendment has introduced a requirement for permission for a covered block (see below). Apart from that, the Czech Covered Bonds Rules do not lay down any further requirements for a special authorisation or any requirements for an issuer to be set up as a specialised credit institution (with a restricted scope of permitted activities, for instance).

The Czech Covered Bonds Rules operate on the dual-recourse concept (with holders of covered bonds having a direct, unconditional and senior unsecured claim vis-à-vis the issuer, and a preferential claim on the cover pool). This means that the assets in the cover pool(s) are reserved for the preferential satisfaction of claims of holders of covered bonds and the repayment of certain other debts so designated in the Czech Act on Bonds, and the terms and conditions or the prospectus of covered bonds or in an agreement related to covered bonds (the relevant parts of which must be disclosed to the investors in the same manner as the terms and conditions or the prospectus of covered bonds). Consequently, the covered bond holders have a dual recourse against (i) the relevant cover pool; and (ii) the insolvency estate of the issuer.

IV. COVER ASSETS, COVER ASSETS REGISTER AND COVERED BLOCK RECORDS

The eligible assets comprise the following asset classes:

- (i) mortgage loan receivables;
- (ii) receivables against, or receivables guaranteed by, a person controlled by a state, regional self-governing unit or an individual or legal person performing tasks in the area of public administration so long as certain conditions stipulated under the Czech Act on Bonds are met (**Public Undertaking Receivables**);

- (iii) other assets or exposures under Article 129(1) and (2) of the Credit Requirements Regulation so long as the issuer meets the requirements laid down in paragraphs 1a to 3 of Article 129 of the CRR;
- (iv) the issuer's cash on an account kept by a bank or another person set out in Czech Act No. 240/2013 Coll., on Investment Companies and Investment Funds, as amended (the Issuer's Cash) and other Liquid Assets (as defined below); and
- (v) rights arising under a derivative in accordance with Article (2)(5) of Regulation (EU) No. 648/2012 of the European Parliament and of the Council, on OTC derivatives, central counterparties and trade repositories (EMIR) (the **Derivative**).

A Derivative is considered an eligible asset only if the following cumulative conditions are met:

- (i) the purpose of the Derivative is to hedge against the risks related to cover assets or covered bonds;
- (ii) the Derivative was clearly concluded in relation to covered bonds;
- (iii) the terms of the Derivative provide that the insolvency of an issuer, crisis resolution or similar measure in respect of an issuer cannot constitute an event of default or similar event which could lead to early termination of the Derivative; and
- (iv) the issuer's counterparty to the Derivative has granted its prior consent to the registration of the Derivative in the cover assets register (while the same applies also to its removal from the cover assets register) whereas where the issuer's counterparty to the Derivative is a financial counterparty within the meaning of Article 2(8) of Regulation (EU) No. 648/2012 it must have been assigned at least with a credit quality step 3, and the derivative contract must have been sufficiently documented.

Upon registration of an eligible asset in the cover assets register, it becomes a cover asset, which is protected by the Czech Act on Bonds and cannot be transferred, pledged or otherwise used as a security (until deregistered from the cover asset register).

Depending on the type of covered bonds involved, particular eligible assets will have to constitute such cover that the aggregate value of certain cover assets in the cover pool must be equal to at least 85% of the aggregate value of all debts for whose cover the cover pool serves (the Statutory 85% Limit), unless a higher limit is stipulated by the terms and conditions of a series of covered bonds. In meeting this limit, the following cover assets are always disregarded: (i) the Issuer's Cash; (ii) rights arising under a Derivative; and (iii) assets under Article 129(1)(c) and 129(2) of the CRR.

Besides the cover assets, the cover pool also includes, without the need of their registration in the cover assets register, the following assets (each designated as an accessory asset):

- (i) rights from a security provided in relation to the cover asset included in the cover pool, in particular rights from mortgages of real property in relation to the mortgage loans;
- (ii) rights from agreements entered into in relation to the cover assets included in the cover pool (especially rights from any insurance agreements or policies);
- (iii) an asset provided as a collateral or other security in respect of a Derivative, unless the terms and conditions of a series of covered bonds provide otherwise;
- (iv) rights from agreements concluded in relation to the administration of the covered block whose part is the cover pool; and
- (v) upon appointment of an involuntary administrator of covered blocks, funds accepted as payment for the repayment of a debt corresponding to a receivable arising under another (cover) asset that is included in the cover pool or in direct connection with such an asset or funds obtained as a proceeds from cover assets liquidation.

The cover assets register forms the core part of the covered block records that an issuer of covered bonds (or involuntary administrator of the covered blocks, once appointed) is obliged to keep. The cover assets register, and the covered block records must be kept separately in respect of each cover pool and each covered block. The covered block records must provide complete information for assessing whether and how the issuer fulfils its duties under the Czech Act on Bonds. Further details on how the covered blocks records should be kept are laid down under delegated regulation to the Czech Covered Bonds Rules.

V. COVER POOL(S) AND COVERED BLOCK(S)

The cover pool is created upon registration of at least one eligible asset in the cover assets register. The issuer may, at its sole discretion, create only one cover pool or multiple cover pools, which may serve to cover its obligations from individual or multiple series of outstanding covered bonds or all series of covered bonds issued under one covered bond programme.

The cover pool is a fully segregated and ring-fenced pool of assets registered in the cover assets register, identified and designated by the issuer to constitute cover in respect of certain covered bonds that it has issued (and which are outstanding) and certain other debts of that issuer, as well as other assets (the accessory assets) which belong to that cover pool by operation of law. Any assets included in the cover pool must be held by the issuer and those assets will remain at all times on the issuer's balance sheet.

The issuer is obliged to monitor the eligibility of the assets in the cover pool continuously. The issuer must remove from the cover assets register those assets that no longer satisfy the eligibility criteria from the cover pool and substitute them with other eligible assets. However, the involuntary administrator of covered blocks, if and once appointed, has no such duty. The priority right of holders of covered bonds to the cover pool(s) extends also to any overcollateralisation.

With the creation of one or more cover pools, an issuer also creates a covered block, which is a fully segregated and ring-fenced block of assets and liabilities (debts) of that issuer. A covered block consists of the cover pool and the debts that it covers.

The CBD Amendment introduces a requirement for covered block permission. Consequently, each issuer of covered bonds must, no later than on the issue date of the relevant covered bonds, obtain permission for a covered block granted by the CNB. The Czech Act on Bonds stipulates conditions for both the granting and removal of that permission.

VI. COVER POOL LIQUIDITY BUFFER

The CBD Amendment has introduced a requirement that a cover pool must at all times include a cover pool liquidity buffer composed of the following liquid assets (each a **Liquid Asset**):

- (i) assets qualifying as level 1, level 2A or level 2B assets under Commission Delegated Regulation 2015/61, that are valued in accordance with that delegated regulation, and are not issued by the credit institution issuing the covered bonds itself, its parent undertaking, other than a public sector entity that is not a credit institution, its subsidiary or another subsidiary of its parent undertaking, or by a securitisation special purpose entity with which the credit institution has close links; or
- (ii) short-term exposures to credit institutions that qualify for credit quality step 1 or 2, or short-term deposits to credit institutions that qualify for credit quality step 1, 2 or 3, in accordance with point (c) of Article 129(1) of the CRR.

According to the Czech Covered Bonds Rules, claims from exposures considered in default under Article 178 of the CRR cannot contribute to the cover pool liquidity buffer.

The cover pool liquidity buffer will cover the maximum cumulative net liquidity outflow over a period of 180 days. Where the issuer of covered bonds is subject to liquidity requirements set out in other EU acts that result

in an overlap with the cover pool liquidity buffer, the provisions of the Czech Act on Bonds regulating cover pool liquidity buffer do not apply for the period provided for in those EU acts.

VII. EXTENDED MATURITY (SOFT-BULLET) STRUCTURES

The Czech Covered Bonds Rules allows the issuers to issue covered bonds with a feature of extending their scheduled maturity for a pre-determined period of time if a specific trigger event specified in the terms and conditions of a series of covered bonds occurs. Note that only the events recognised under the Czech Act on Bonds may be used as trigger events for the purposes of an extended maturity structure feature.

VIII. ASSET MONITOR AND INVESTOR INFORMATION

The CBD Amendment has not introduced a requirement for the issuers of covered bonds to appoint mandatory asset (or cover pool) monitor within the meaning of Article 13 of the CBD. However, the issuers are free to appoint asset (or cover pool) monitor which, however, does not have to follow the requirements placed on 'obligatory' cover pool monitors under Article 13 of the CBD.

Under the Czech Covered Bonds Rules, the issuers of covered bonds are required to publish information about their covered blocks so that the investors may assess the profile and risks of a particular covered block and carry out their due diligence. The scope of the information that must be published on the issuer's website is laid down under the Czech Act on Bonds (and follows Article 14(2) of the CBD).

IX. STATUTORY MINIMUM OVERCOLLATERALISATION LEVEL AND OTHER TESTS

The Czech Covered Bonds Rules further require the aggregate value of all cover assets included in the cover pool to represent at least 102% of the aggregate value of all debts that are covered by the respective cover pool (whereas the expected costs relating to the maintenance and administration of the covered block in the amount of 1% of the cumulative nominal amount of the covered bonds falling within that covered block will always be added) and thus resulting in a minimum 2% overcollateralisation (the **Statutory Minimum OC Level** and the Statutory 85% Limit and the Statutory Minimum OC Level, jointly also the **Cover Tests**).

Where the issuer of the covered bonds meets the Statutory 85% Limit predominantly using the Public Undertaking Receivables, the Statutory Minimum OC Level is modified. In that case, the aggregate value of all cover assets included in the cover pool must represent at least 110% of the aggregate value of all debts that are covered by the respective cover pool. The terms and conditions of a series of covered bonds may also set a higher overcollateralisation level.

In the case of mortgage covered bonds, the nominal value of any mortgage loan receivable in the cover pool must not exceed 100% of the mortgage lending value of the mortgaged real property (the Statutory 100% Individual LTV Limit), unless a lower limit is stipulated by the terms and conditions of a series of covered bonds (which may implement stricter, CRR-conform criteria in their programmes or an individual series of covered bonds). However, this requirement does not operate as a strict eligibility criterion (but is rather set as a soft limit only) since, to the extent the nominal value of an individual mortgage loan exceeds that limit, it will be partially disregarded for the purposes of calculating the Cover Tests.

The issuer regularly (at least each calendar quarter) informs the CNB on whether and how the issuer meets its duties, including, but not limited to, compliance with the Cover Tests and the Statutory 100% Individual LTV Limit.

X. MORTGAGE LOANS – ELIGIBILITY CRITERIA

Mortgage loans included in the issuer's cover pool(s) are subject to certain conditions, including that:

(i) the mortgaged real property must be located in Czechia or in an EEA country;

- (ii) compliance with the Statutory 100% Individual LTV Limit is ensured (which is, however, set as a soft limit rather than as a strict eligibility criterion, whilst, to the extent the nominal value of an individual mortgage loan exceeds that limit (and only to that extent), it will be partially disregarded for the purpose of the Cover Tests);
- (iii) there may not be any other mortgage or similar third-party right attached to the mortgaged real property having the same or priority ranking to those mortgage rights securing mortgage loan receivables (or a part of them) used as a cover (if this condition is not met, the nominal value of the relevant mortgage loan is equal to zero for the purposes of the Statutory 85% Limit); and
- (iv) the issuer of covered bonds must have in place procedures to monitor that the mortgaged real property is adequately insured against the risk of damage and that insurance claim under relevant insurance contract are included in the respective cover pool.

Additionally, in the case of a default of a borrower under the relevant mortgage loan under Section 178 of the CRR (or if a stricter condition set out in the relevant terms and conditions is met), the nominal value of the relevant mortgage loan receivable in the cover pool will be equal to zero (ie decreased by 100%) for the purpose of calculating the Cover Tests.

XI. ENHANCED PROTECTION AND FULL RING-FENCING IN INSOLVENCY

The Czech Insolvency Act explicitly provides that cover pool(s) do not constitute a part of the issuer's insolvency estate and are fully segregated and ring-fenced from any other (general) assets of the issuer which fall within the issuer's insolvency estate, regardless of whether the aggregate value of these assets is lower or higher than the limits set out in the Czech Act on Bonds. The Czech Insolvency Act further provides that:

- (i) the automatic acceleration of debts from covered bonds as a result of the commencement of insolvency proceedings and declaration of bankruptcy in relation to the assets of the issuer will not apply (which on its own represents an extremely credit-positive change compared with the previous regulatory regime);
- (ii) neither the commencement of the insolvency proceedings against the issuer, the issuing of a decision on the insolvency of an issuer nor the declaration of bankruptcy in relation to the assets of an issuer will affect the covered block(s) (especially the satisfaction and maturity of debts that are part of that covered block(s)); and
- (iii) the insolvency administrator must not intervene in the administration of the covered block (which is entrusted to the involuntary administrator) and must render assistance to the involuntary administrator of covered blocks.

XII. INVOLUNTARY ADMINISTRATOR OF COVERED BLOCKS

Upon (i) commencement of the insolvency proceedings in respect of an issuer of covered bonds, (ii) the issuer of covered bonds enters into liquidation; and (iii) the CNB revokes the banking licence of the issuer of covered bonds, the CNB will, without undue delay, appoint an involuntary administrator of covered blocks to ensure proper management of the covered blocks.

The involuntary administrator of covered blocks may only be a Czech bank or a foreign bank with its registered office in another EEA country that issues securities comparable to covered bonds or that administers assets comparable to cover assets, and it cannot be a person in respect of which there is a risk of a conflict of interests.

The involuntary administrator of covered blocks is entrusted with full administration of all covered blocks of the relevant issuer and may agree an obligation both for the benefit and to the detriment of a covered block to improve liquidity or hedge against risk.

The involuntary administrator of covered blocks must, without undue delay after its appointment, open an account with a bank to accept payments, and inform the persons whom this may concern about an unequivocal

identifier of that account. Any other person that receives a payment in favour of the cover pool will, without undue delay, transfer it to that account or to the involuntary administrator of covered blocks in favour of the relevant cover pool.

The involuntary administrator of covered blocks may:

- (i) transfer the relevant covered block to another eligible entity and entrust it with its administration (whilst a transfer made without the consent of the CNB will be disregarded);
- (ii) conduct a proportional decrease (*a pari passu* haircut) of debts belonging to the covered block;
- (iii) liquidate selected cover assets (cover pool(s)); or
- (iv) liquidate all the cover assets (cover pool(s)) and consequently proceed with early repayment of the covered bonds).

In all instances, only the CNB's consent is required and the CNB will only grant its consent so long as any of these actions is in the best interest of the holders of covered bonds. The effectiveness of the transfer, the *pari passu* haircut, or the liquidation towards third parties does not require any other (prior or subsequent) public or private consent or notification.

Issuers: Česká spořitelna, a.s., Hypoteční banka, a.s., Komerční banka, a.s., Raiffeisenbank a.s., MONETA Money Bank, a.s., UniCredit Bank Czech Republic and Slovakia, a.s., Wüstenrot hypoteční banka a.s (now MONETA Money Bank, a.s.), Equa Bank a.s. (now Raiffeisenbank a.s.)



COVERED BOND LABEL | Komerční banka, a.s. (1 pool), UniCredit Bank Czech Republic and Slovakia, a.s. (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 or via the following QR code:

