

3.14 FINLAND

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I. FRAMEWORK

In Finland, the legal basis for covered bond issuance is the Act on Mortgage Credit Banks and Covered Bonds (151/2022). The law entered into force on 8th July 2022. The legislative framework is adopting the necessary changes of the harmonized EU legal framework (EU directive 2019/2162 and EU Regulation 2019/2160).

The former Act on Mortgage Credit Bank Operations (688/2010) is still governing the issuance issued before July 2022 and the possible tap issues to at the time existing bonds.

II. STRUCTURE OF THE ISSUER

The issuer of Finnish covered bonds can be a universal bank or a specialist mortgage bank. Generally, entities that can issue covered bonds are credit institutions authorised to engage in mortgage credit bank operations. Starting from 2022 onwards the application for the authorization process is based on the EU harmonized legal framework. Currently the issuer of Finnish Covered Bonds can be a specialised mortgage bank, but also deposit banks or credit entities are entitled to apply for a license to engage in mortgage credit bank operations (i.e., issue covered bonds).

There are currently ten potential issuers of Finnish covered bonds.

The Finnish Covered Bond Law stipulates certain requirements to receive a covered bond issuance license. The covered bond issuer should provide a business plan, show stability, expertise in mortgage credit operations, risk management and practices concerning valuation of collateral. Interestingly, the requirements to receive a Finnish Covered Bond License seem very similar to the requirements to receive a German Pfandbrief License. All Finnish issuers had to reapply for the license in connection with the change of the legislation.

The issuer holds the cover assets on the balance sheet. A subsequent transfer of the cover assets to another legal entity is not taking place. A direct legal link between single cover asset and the covered bonds issued does not exist. All obligations from Finnish Covered Bonds are direct and unconditional obligations of the issuing bank as a whole (dual recourse). In the case of insolvency, the cover pool is segregated by law from the general insolvency estate and is reserved only for the claims of the holders of Finnish Covered Bonds.

Issuers may have several active cover pools. Most of the issuers have separate cover pools for the operations taking place under the new legislation (the Act on Mortgage Credit Banks and Covered Bonds (151/2022)) and the former pool remains as actively managed run off pool.

III. COVER ASSETS

Finnish covered bonds have a cover pool register that includes all cover pool assets, covered bonds and derivatives. Eligible assets for Finnish covered bonds are residential mortgage loans (including shares in Finnish housing companies), commercial mortgage loans, public sector loans in accordance with Article 129(1) CRR and substitution assets. At least 90% of the cover pool loans must consist of residential mortgage loan or public sector loans. In the current legislation (151/2022) the amount of substitution assets is limited to 20% of the cover pool. Assets securing the liquidity requirement (180 days outflow coverage) are excluded of this restriction. The geographical scope of cover assets is restricted to the European Economic Area.

Enforcement of non-Finnish cover pool assets would usually be determined by the laws of the jurisdiction in which the assets are located. Due to European Union law, inside the EU, enforcement is safeguarded in all Member States anyway. However, majority of Finnish issuers have only Finnish assets in the covered bond pools. The assets eligible as cover pool assets need to fulfil the EU Regulation 575/2013 article 129 requirements.

Specialised mortgage credit bank can grant an intermediate credit to a deposit bank or a credit entity. This intermediate credit must be covered with eligible cover assets as stated above. These assets must also be recorded into the cover register.

Up to 20% of the mortgage cover pool is allowed to consist of substitute cover assets. As collateral securing a covered bond, the following types of substitution assets meeting the requirements laid down in Article 129 of the EU Capital Requirements Regulation may be used on a temporary basis:

- 1) assets qualifying as level 1, level 2A or level 2B assets eligible to meet the liquidity buffer requirements of a credit institution pursuant to the applicable delegated regulation adopted pursuant to Article 460 of the EU Capital Requirements Regulation;
- 2) short-term exposures to credit institutions or short-term deposits to credit institutions referred to in Article 129(1)(c) of the EU Capital Requirements Regulation.

Instruments, the counterparty of which shall be deemed to be insolvent within the meaning of Article 178 of the EU Capital Requirements Regulation, or which are financial instruments issued by the issuer itself or by an entity affiliated to it, shall not be used as substitution assets.

ABS or MBS tranches are not eligible for the cover pool.

Derivatives are eligible for the cover pools only if they are used for hedging purposes. The nature of the cover pool is dynamic. Currency risk is perfectly matched, as the law requires cover assets to be in the same currency as the covered bonds.

IV. VALUATION AND LTV CRITERIA

The property valuation within the legal framework for covered bonds in Finland is based on market values, valuations are based on "current value", market value determined in accordance with FFSA regulations. Based on the regulation, the issuer needs to monitor the valuation of the property also based on statistical methods (indexed value) quarterly and set limits for the acceptable changes of the values. Should the value exceed or drop below the limits the property valuation needs to be updated accordingly.

There are different LTV levels for residential and commercial mortgage loans: 80% of the value of the residential property 60% of the value of the commercial property accepted and the principal of other receivables. This LTV is a relative limit, i.e. when a loan exceeds the 60%/80% limit, the part of the loan up to 60%/80% LTV remains eligible to the cover pool. A loan placed as collateral for a covered bond may not exceed the current value of the property standing as collateral.

V. ASSET – LIABILITY MANAGEMENT

The net present value of the total amount of collateral of covered bonds shall continuously exceed by at least 2% the total net present value of the payment liabilities resulting from the covered bonds. The net present value test helps mitigate interest-rate, currency and liquidity risk. If the requirements laid down in Article 129(3)(a)(3) of the EU Capital Requirements Regulation are not met, the overcollateralization value shall be at minimum five per cent. In addition to the part laid down in this subsection, the overcollateralization shall also cover the estimated winding-down costs related to covered bonds.

In calculations based on the nominal value, the cover assets in the cover pool and the impact of currency derivatives contracts shall be considered when determining the obligations incurred from covered bonds. In calculations based on the present value, the value of derivatives contracts shall be determined based on present value at the time of valuation.

In calculations based on both the current and the nominal value, any increased credit loss risk of the secured receivable shall be appropriately accounted for, at least in cases where the receivable shall, pursuant to Article 178 of the EU Capital Requirements Regulation, be considered non-performing.

The issuer shall also ensure that the cover pool continuously contains an amount of funds that meets the quality requirements laid down in the legislation and covers the maximum cumulative net liquidity outflow relating to covered bonds over the next 180 days (liquidity buffer requirement).

To determine the net outflow rate referred to above, the issuer may use as the maturity date of a covered bond the final maturity date (soft bullet).

VI. TRANSPARENCY

Obligation to regularly disclose information on covered bonds. The issuer shall publish the following information on covered bonds on their website at least quarterly:

- 1) the total value of the cover assets and issued covered bonds;
- 2) the international securities identification numbers (ISINs) of the covered bonds;
- 3) distribution of cover assets by type; for residential loans, however, this information shall be itemised into loans to natural persons, loans to housing companies and loans to other housing associations;
- 4) geographical distribution of collateral for loan receivables, description of the assessment methods, and information on the credit amounts of loan receivables;
- 5) information on the market risks associated with the covered bonds, including interest rate risk and currency risk, as well as credit risks and liquidity risks;
- 6) information on the maturity of covered bonds, including any requirements for extending the maturity of a bond as well as the legal and any other effects of extending maturity;
- 7) the available collateral and minimum collateral level, including the minimum level laid down in legislation for overcollateralization, overcollateralization required under the terms and conditions of a bond or bond programme as well as the total value of the cover pool in excess of these; and
- 8) the share in the cover pool of loan receivables that either meet the requirements laid down in Article 178 of the EU Capital Requirements Regulation or the matured principal or interest of which has otherwise remained unpaid for at minimum 90 days.

Finnish covered bond issuers have adopted the ECBC Label initiative for Covered Bonds and publish also the Finnish National Transparency Template on their websites. The ECBC Label Transparency Guidelines included in the Covered Bond Label Convention for 2014 are fully aligned and compliant with Art. 129 (7) CRR.

On top of the regulatory requirements all issuers provide additional information about the cover pools, ratings and other relevant topics on their websites. Please find the information about the website below (section X).

VII. COVER POOL MONITOR AND BANKING SUPERVISION

The issuer carries out the monitoring of the cover pool. The issuer reports to the FSA on quarterly basis. The FSA is responsible for overall supervision, covered bond licensing, issuing regulations and compliance with the law. Issuers also update the mortgage credit bank operations business plan with e.g. issuance plans annually to FSA.

The FSA has the legal power to take appropriate measures. It is allowed to conduct inspections at the bank in question or to require documents. Also, the FSA could issue a public warning or admonition. Ultimately, it is up to the FSA to revoke the banking license of the bank in question.

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

A cover register allows identifying the cover assets. The legal effect of a registration of assets into the cover register is to create the priority claim of covered bond holders to these cover assets in case of an insolvency of the issuer. The cover register is managed by the corresponding bank, which in turn is supervised by the FSA.

The cover register contains information about the principle amount of covered bonds issued, the mortgages and substitute assets covering these bonds as well as derivative transactions hedging these bonds or funds placed as their collateral. The Covered Bond act (151/2022) specifically excludes set-off against cover pool assets.

Asset segregation

When the issuer or the debtor of an intermediary loan has entered into liquidation or been declared bankrupt, the Financial Supervisory Authority (the FSA) shall without delay appoint an administrator to supervise the appropriate administration of covered bonds and liquidation of the cover assets.

The cover pool is a part of the general estate of the bank as long as the issuer is solvent. If the insolvency proceedings are opened, by operation of law, the assets recorded in the cover registers are excluded from the general insolvency's estate. Within the insolvency procedure, the derivative counterparties rank *pari passu* to covered bond holders. The cover assets do form a separate legal estate, which is ring-fenced by law from other assets of the issuer.

Impact of insolvency proceedings on covered bonds and derivatives

Covered bonds do not automatically accelerate when the issuing institution becomes insolvent. The legal consequences for the derivatives in case of an insolvency of the issuing bank depend on the relevant contracts. The cover pool administrator can only accelerate the covered bonds if the cover tests can no longer be fulfilled. This would trigger the sale of the cover pool assets.

The cover pool administrator will supervise cover pool cash flows and payments to covered bondholders. The general administrator also has powers to act in the interests of the covered bondholders under the direction of the cover pool supervisor. This includes the ability to assign the liability for a covered bond as well as the related cover pool assets to another licensed covered bond issuer.

The administrator shall work together with the FSA and, where applicable, the Resolution Authority. The administrator has the right to obtain the information necessary for performing their duties from the Financial Supervisory Authority and the Resolution Authority. Similarly, the Financial Supervisory Authority and the Resolution Authority have the right to obtain the information necessary for performing their duties from the administrator.

Preferential treatment of covered bond holders

Covered bond holders enjoy a preferential treatment as the law stipulates the separation of the cover assets on the one hand and the insolvency's estate on the other.

Covered bond holders are allowed claims on both on the issuer and cover pool assets (dual recourse) meaning that creditors also participate in the insolvency proceedings in respect of the remaining assets of the bank.

A moratorium on the insolvency's estate cannot delay the cash flows from the cover assets and, therefore, endanger the timely payment of covered bond holders.

Access to liquidity in case of insolvency

With the appointment of the cover pool administrator, this person acts on behalf of the covered bond holders. The pool administrator has access to the cover assets. Cover assets may only be disposed with the consent of the FSA. Additionally, the pool administrator has also the first access on cash flows generated by the cover assets. The law foresees a possibility for the pool administrator together with the bankruptcy trustee to take up a loan on behalf of the cover pool to create more liquidity.

Up to 20% of the cover pool may consist of liquid substitute cover assets. Substitute assets are described earlier on section "Cover Assets". With the consent of the FSA, this limit may even be higher. As all cover assets entered into the cover register are ring-fenced in case of an insolvency of the issuer, this results also in the insolvency remoteness of voluntary overcollateralisation.

Some Finnish covered bonds mitigate liquidity risk via contractual twelve-month maturity extensions ("Soft Bullet"). The extension provides additional time for principal amounts to be refinanced. Maturity extensions improve the chance that principal and interest payments can be met without refinancing the covered bonds for the first twelve months after issuer default.

The maturity extension, subject to permission granted by the Financial Supervisory Authority, extend the maturity of the covered bond. The prerequisites for extension of maturity are that:

- 1) the issuer is unable to obtain funding from commonly used sources of long-term funding;
- 2) the issuer is unable to repay the principal and interests of the maturing covered bond without falling short of the liquidity buffer requirement applicable to the issuer or the amalgamation of deposit banks; and
- 3) the extension does not affect the order of maturity based on the original maturity dates of covered bonds secured by the same cover pool.

The issuer shall apply to the Financial Supervisory Authority for permission to extend maturity as referred to in this section at the latest five banking days before the maturity date of the covered bond.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

The Finnish Act on Mortgage Credit Banks and Covered Bonds 151/2022 ("the Covered Bond Act") comply with the requirements of the Directive (EU) 2019/2162 of the European Parliament and of the Council of 27 November 2019 on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU (the Covered Bond Directive) and Regulation (EU) 2019/2160 of the European Parliament and of the Council of 27 November 2019 amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds (the Covered Bond Regulation). The Covered Bond Regulation amended Article 129 of the Capital Requirements Regulation (and certain related provisions) and further strengthened the criteria for covered bonds that benefit from preferential capital treatment under the Capital Requirements Regulation regime.

Finnish covered bonds are 10% risk weighted in Finland. Following the common practice in Europe, they accordingly enjoy a 10% risk weighting in most European countries and fulfill the requirement to be considered European Covered Bonds (Premium) quality.

Finnish Covered Bonds are also eligible in repo transaction with national central bank, i.e. within the Euro-zone. As far as the domestic issuers are aware, there are no further specific investment regulations regarding Finnish Covered Bonds.

The previous Finnish Covered Bond legislation (the Finnish Covered Bond Act 688/2010, "The MBA") included already most of the topics described in the EU Harmonization package (Article and Directive). The MBA continues to apply to covered bonds issued thereunder unless the terms and conditions of such covered bonds provide that the Covered Bond Act applies to them.

X. REGULATIVE LIMITS IN MORTGAGE LENDING

Financial service providers have a statutory obligation to identify and know their customers.

The loan cap limiting the maximum LTV level is currently 85%. For a first home purchase the cap is at 95%. Borrower's ability to pay the loan and handle the regular living costs is stress tested with 6% interest rate.

Issuers: Aktia Bank Plc, Danske Bank, OP Mortgage Bank, Nordea Mortgage Bank, Ålandsbanken AB, The Mortgage Society of Finland, SP-Mortgage Bank Plc, Oma Savings Bank, S-Bank Plc and Bonum Bank Plc



COVERED BOND LABEL : Nordea Mortgage Bank (2), Op Mortgage Bank (3), Danske Bank (1), SP-Mortgage Bank (2)

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:

