

### **3.25 LITHUANIA**

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#### **I. LEGAL FRAMEWORK**

Since 2017 Lithuania was working on its regulation of covered bonds and securitisation. As a result, the Introduction of a Covered Bond and Securitisation Legal and Regulatory Framework in Lithuania was published in 2017, followed by the drafting of the Law on Securitisation and Covered Bonds (the **Draft Law**) presented for public discussion on 18 July 2018.

After preparing the Draft Law, on 22 July 2022 Lithuania has finally adopted Law on Securitisation and Covered Bonds (the Law on Securitisation and Covered Bonds).

#### **II. STRUCTURE OF THE ISSUER**

In Lithuania, covered bonds can be issued by an authorized credit institution. However, before issuing covered bonds the credit institution has to obtain an additional authorisation from the Bank of Lithuania which is the Lithuanian financial supervisory authority (the **Lithuanian FSA**). A prospective issuer who is applying for the authorization has to prove that it will comply with the requirements imposed upon the issuer by the Law on Securitisation and Covered Bonds. For example, a prospective issuer is required to have technology and systems, control mechanisms and a risk management system necessary for the administration of the cover pool. Moreover, it has to have a contingency plan.

Lithuania has chosen and adopted the SPV model for covered bonds. As a result, the assets included in the cover pool are transferred to an SPV under the *true sale* principle and the investors are granted the *dual recourse* right. Therefore, the credit institution, as the issuer, has a direct responsibility for redemption, but the cover pool is *ring-fenced* in the SPV and the issuer's creditors do not have any claim rights against it.

The day-to-day supervision of covered bond programs shall be undertaken by a cover pool monitor. In specific, the cover pool monitor will inspect the compliance of the issuer with the requirements of the Law on Securitisation and Covered Bonds, in particular whether the asset pool is, during the whole period of validity of the regulated covered bond, capable of covering claims attaching to the bond and sums required for the maintenance, administration and winding up of the asset pool (operational expenses) and for the transfer of the asset pool to a third-party servicer; whether the cover pool is of sufficient quality to give investors the confidence that in the event of the failure of the issuer there will be a low risk of default in the timely payment by the covered bond entity of claims attaching to the bond; whether the eligible property in the cover pool of a single asset class bond consists only of eligible property of the same class as the eligible property included in the asset pool of the regulated covered bond when registered and/or liquid assets and/or derivatives, etc.

#### **III. COVER POOL**

Cover assets shall mean an "asset pool" comprised of the following:

- (1) primary cover assets:
  - a. public sector assets indicated in Article 129(1)(a) and (b) of the Capital Requirements Regulation (the **CRR**), except for exposures that are eligible for credit quality category 2 as referred to in part (b) thereof;
  - b. residential mortgage assets – loans covered by non-commercial real estate as provided for in Article 129(1)(d) and (e) of the CRR;
  - c. commercial mortgage assets – loans covered by commercial real estate as provided for in Article 129(1)(f) of the CRR;
  - d. loans covered by liens on ships as provided for in Article 129(1)(g) of the CRR;

e. other high-quality assets classified as eligible assets by the Lithuanian FSA in accordance with Article 129 of the CRR.

(2) cash from the assets that are part of the asset pool;

(3) eligible derivatives (for hedging purposes only);

(4) liquid debt securities issued by an EEA country, regional government or local authority of an EEA country.

Nevertheless, only the performing credits could be included in the cover pool as primary cover assets. The primary cover assets shall constitute no less than 80 % (eighty per cent) of collateral assets under relevant bonds issue. The substitution assets shall not exceed 20 % (twenty per cent) while the assets as provided for in Article 129 (1)(c) shall not exceed 15 % (fifteen per cent) of collateral assets under relevant bonds issue. The statutory over-collateralization level should be no less than 5% (five per cent) of the total principal amounts outstanding in relation to the bonds which the asset pool relates to.

#### **IV. VALUATION AND LTV CRITERIA**

Law on Securitisation and Covered Bonds provides that the LTV criteria for the property given as collateral for the credits linked to the real estate assets of the issuer must abide by the following maximum percentages: residential mortgages – 70% (seventy per cent) of the value of property valuation and commercial mortgages – 60% (sixty per cent) of the value of property valuation.

Market value indexation should be performed at least once a year, i.e. the loan-to-asset value ratio should be adjusted on an annual basis, unless higher indexation is provided in the covered bond programme or more frequent indexation is required by the cover pool monitor or the Lithuanian FSA.

Law on Securitisation and Covered Bonds entitles the Lithuanian FSA to elaborate on the criteria for assessing the eligibility of loans to be included in the cover pool and for the valuation of the underlying assets.

#### **V. ASSET AND LIABILITY MANAGEMENT**

The issuer has an obligation to perform a stress test on the covered bond portfolio and assess the impact of the main risk factors to which the asset portfolio is exposed in relation to the sufficiency requirement. The stress test should cover at least the interest rate, currency, credit, liquidity, set-off, commingling risks and other risks as indicated by the Lithuanian FSA. When carrying out the stress tests, the relevant risk-mitigating factors such as derivative contracts and other agreements entered into for the purpose of risk mitigation must be taken into account. Stress testing must be done at least once a quarter.

Such stress tests must be carried out by the issuer according to its own approved methodology based on consistent, documented and verifiable criteria, assumptions and procedures. The managers of the issuer are responsible for ensuring the performance of stress tests.

Law on Securitisation and Covered Bonds grants the Lithuanian FSA the right to establish more detailed requirements for the procedure and methodology of stress testing of covered bond portfolios.

Regarding the liquidity requirement, the cover pool must contain liquid assets in an amount equivalent to the issuer's related commitments secured by the cover pool and falling due in the next 180 days.

#### **VI. TRANSPARENCY**

In addition to the disclosure obligation arising from other legislation, an issuer must disclose information about covered bond portfolios on a quarterly basis. The following information is required to be disclosed to the holders of regulated covered bonds:

(1) information on the credit, market, currency, interest and liquidity risks associated with the cover assets and the covered bonds;

- (2) the total nominal value of the outstanding covered bonds;
- (3) the total value and composition of the cover assets and the geographical distribution of the cover assets;
- (4) the ratio between the total value of the cover assets and the total nominal value of the outstanding covered bonds, over-collateralization, including voluntary over-collateralization;
- (5) information about a liquidity buffer;
- (6) information on the structure of the covered bonds, including the maturity profile of both the cover assets and the outstanding covered bonds;
- (7) the methodology used to calculate LTVs for mortgage assets;
- (8) the percentage of the cover assets with payments past due by more than ninety days;
- (9) information on the counterparties and the SPV,
- (10) information on stress testing scenarios and its results;
- (11) other relevant information for the investor, as established by the Lithuanian FSA.

The information stated in the first paragraph is to be provided in sufficient detail to enable the regulated covered bond-holders to carry out an adequate risk analysis.

The Lithuanian FSA may establish more specific disclosure requirements, including approval of their standardized formats.

#### **VII. COVER POOL MONITOR AND BANKING SUPERVISION**

The cover assets owned by the SPV must be supervised by a cover pool monitor. The issuer of the covered bond must appoint and dismiss the cover pool monitor. The cover pool monitor may not be a person who was an external auditor of the issuer within the previous three years; also Lithuanian FSA has a right request to substitute cover pool monitor.

The cover pool monitor must perform the following functions:

- (1) inspect the compliance of the asset pool with the requirements set out in the Law on Securitisation and Covered Bonds (for example, the existence of a sufficient cover pool and its compliance with the requirements, as well as the accuracy of the records kept in relation to each asset in the asset pool);
- (2) inspect the compliance of the issuer with the requirements related to derivatives, stress testing, liquidity buffers and transparency;
- (3) prepare a report in accordance with the guidance issued by the Lithuanian FSA on the quality of the assets in the cover pool;
- (4) perform other instructions of the Lithuanian FSA.

The cover pool monitor must submit the report to the SPV, the issuer, and the Lithuanian FSA. In addition, the cover pool monitor must immediately inform the management of the SPV, the issuer, the Lithuanian FSA and, as the case may be, the representative of the investors about any irregularities and inaccuracies discovered during the performance of the cover pool monitor's duties.

#### **VIII. SEGREGATION OF THE COVER POOL AND BANKRUPTCY REMOTENESS OF COVERED BONDS**

As pointed out above, Lithuania has chosen and adopted the SPV model for covered bonds. As a result, the assets included in the cover pool are transferred to an SPV under the *true sale* principle and the cover pool is *ring fenced* in the SPV, and therefore the issuer's creditors do not have any claim rights against the cover pool. Moreover, the Law on Securitisation and Covered Bonds imposes the obligation to ensure that the SPV is independent from the issuer and is not consolidated with the issuer upon its insolvency.

In the event that the issuer is declared insolvent, the cover pool will be considered to be separated from the other assets of the issuer under the Law on Securitisation and Covered Bonds and will not be part of the issuer's insolvency estate. Upon the issuer's insolvency, court appoints a special administrator who is recommended by the Lithuanian FSA to take over the management of the cover pool and covered bond program. The special administrator must manage covered bond portfolios with the necessary diligence and in a manner ensuring that the liabilities arising from the covered bonds and from the derivative instruments are met in the best possible way.

Covered bond holders enjoy preferential treatment as the Law on Securitisation and Covered Bonds stipulates the *ring fencing* of the cover assets in the case of the issuer's insolvency. Bond holders have the first access rights to the cash flows generated by the assets included in the cover pool, and it is forbidden to challenge the asset transfer to the cover pool.

### **IX. COMPLIANCE WITH EUROPEAN LEGISLATION**

The Law on Securitisation and Covered Bonds is in compliance with the following European legislation that sets out requirements regarding covered bonds:

- (1) Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS);
- (2) Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012;
- (3) Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891/EEC, and Directives 2001/24/EC, 2002/47/EC, 2004/25/EC, 2005/56/EC, 2007/36/EC, 2011/35/EU, 2012/30/EU and 2013/36/EU, and Regulations (EU) No 1093/2010 and (EU) No 648/2012, of the European Parliament and of the Council Text with EEA relevance;
- (4) 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.

**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](http://www.coveredbondlabel.com) or via the following QR code:**

