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I. FRAMEWORK

The legal framework for Spanish covered bonds – "bonos garantizados" (BG) – is determined by the Royal Decree Law 24/2021 of 2 November 2021 (RDL).

RDL 24/2021 served to transpose not only the Covered Bonds Directive (Directive 2019/2162 of 27 November 2019, CBD) but also a wide range of different directives on many fields. Subsequently some technical improvements were introduced by Royal Decree-Law 5/2023 of 28 June 2023.

RDL 24/2021 regulates Spanish covered bonds (CB) whatever their collateral contrasting with previous legal solution of having different pieces of legislation for mortgage bonds, public sector loans and *internationalization* bonds, although legislation of the two latter was built on the mortgage bonds one.

Although secondary legislation is contemplated as a possibility, mainly referred to the appraisal process of the underlying assets and the approval procedure and supervision by the Bank of Spain (BE), such legislation is con- templated as a mean to improve the RDL but not at all as a condition for its complete and immediate application. As a matter of fact, it only has been approved by the BE the Circular 1/2023, developing in detail the issuers' reporting obligations in line with art. 21.2 of the CBD.

As regards transitional measures, when the RDL came into force – on 8 July 2022 – their provisions were fully applicable to the CB issued before that date, discarding any grandfathering-like solution and so going beyond article 30 of the Directive. This legal option reflects the firm position of the issuers' community in favour to what it was termed as the *big bang* solution, on the basis that keeping two types of CB fragments the market and is very difficult to manage. It is worth to mention that the RDL specifically bans any right of the bondholders affected by the change to claim for the early repayment of the bonds. Consequently, on July 4th 2022, once the issuers had already implemented all the requirements that the RDL envisaged, the BE approved the programs of all the outstanding issuances classifying them as *premium*.

II. STRUCTURE OF THE ISSUER

Issuers of the BG must be credit institutions according to art. 3.1 of the CBD. In Spain universal credit institutions have traditionally been the ones issuing CB. There is not a need of a special license for issuing BG but issuers must have at any moment sufficient capacity and means.

The issuer of the BG directly owns the cover assets forming the pool on its balance sheet and they are not transferred to a different legal entity.

On a different note, in Spain the issuer is normally the originator of the cover assets although nothing in the law prevents their acquisition from another credit institution and moreover *joint funding* (art.9 CBD) is specifically envisaged.

III. COVER ASSETS

Spanish legislation – although common for all the BG – envisages four types of BG, each one having cover assets (*primary assets*) of different nature as collateral.

Furthermore, for each type of primary assets there are two alternatives in order to outline the bonds: *cédulas* – open-ended pools and *bonos* – closed–ended pools. This solution preserves the Spanish traditional legal binary option although as a matter-of-fact issuers in the past have only issued cédulas and apparently it was kept for flexibility reasons. Most RDL provisions are equally applicable to both figures.

The four types of BG are:

a) Mortgage CB (*cédulas y bonos hipotecarios*).

b) Public sector CB (*cédulas y bonos territoriales*).

c) *Internationalization* CB (*cédulas y bonos de internacionalización*).

d) *Other* CB.

The three first types of CB are specifically regulated by the RDL being all them CRR (*EU* Regulation 575/2013 on prudential requirements for credit institutions and investment firms amended by Regulation 2019 /2160 as regards exposures in the form of covered bonds) compliant since their respective regimes meet all the requirements contemplated in said Regulation and particularly the LTV limits and the minimum overcollateralization (OC) ratios stipulated.

Internationalization CB are a sub-type of public sector CB distinguished by their purpose of financing initiatives related to the internationalization of entrepreneurs.

With the fourth category – *Other CB* – Spanish legislator intends to open a door to future issuances of BG backed by assets of different nature to the primary assets, provided art. 6 of the CBD (*Eligible covered assets*) requirements and limits are met.

Assets are normally located in Spain although according to the Directive Spanish law allows assets located in the European Union and even outside (art.7 of the CBD) to be incorporated to the pools.

Mortgage CB (*cédulas hipotecarias*) is the type with the most complete regulation as they have notably been the most important in Spain.

All mortgage loans incorporated to the pool must comply with the following requirements:

> The mortgage that guarantees the loan must be a first-ranked mortgage.

> The recording of the mortgage on the public register must be valid.

> Singular LTV limits are to be respected. We shall expose them in the next chapter.

> The mortgaged properties must have been valued previously by the so-called “Sociedades de Tasación”.

> Mortgaged assets must be insured against damages claims.

> Residential loans cannot exceed 30 years.

Additionally – and for all the three types of specifically regulated CB – RDL permits the incorporation of substitution assets consisting in public debt issued by entities contemplated in art 129.1 a) and b) of the CRR or in short-term deposits to credit institutions contemplated in art 129.1 c). Substitution assets cannot exceed 10% of the total assets and if said limit is supervened exceeded the issuers should either buy back CB or replace the substitution assets by additional primary assets.

Finally, RDL allows joint pools and intragroup structures being their regulation just a literal reproduction of the terms of the CBD (arts. 8 and 9).

IV. VALUATION AND LTV CRITERIA

The RDL develops the general principles laid down in art.6.5 of the CBD as follows.

An updated valuation must exist for all the physical assets when the loans are included in the pool. The valuation should be revised at least yearly.

In the case of mortgage loans, a genuine new appraisal is only necessary when there are signals of a depreciation of the assets pursuant to the solutions envisaged in art.208 of the CRR and incorporated to the Circular 4/2017 of the BE. Additionally, when loans are initially included in the pool and also for subsequent yearly valuations, the value of the assets to consider can never exceed that resulting from the valuation when the loan was granted. Moreover, appreciations if any cannot be considered.

The valuation can be carried out by specialized companies, the "Sociedades de Tasación" (widely regulated in the RDL) supervised by the BE or by independent professionals. This rule is compatible with the use of internal and statistical models/methods where a genuine appraisal is not necessary.

In any case, the valuer must be independent from the credit decision process and in the valuations speculative element should not be considered.

Detailed regulation on the valuation of assets has been issued by the BE (Circular 4/2017).

The valuers must document their assessments having their internal records at the disposal of the CPM and the BE.

In the case of mortgage loans, the basis for the property valuation is the mortgage lending value.

Regarding LTV constrains, the RDL only contemplates them in relation to mortgage CB. Spain was one of the very few countries opting for a system of hard limits when incorporating art. 129 1 of CRR but did it with some peculiarities. The chosen solution maintains what was the traditional rule in Spain.

> When loans are incorporated to the pool, they may not exceed 60% of the mortgage lending value of the mortgaged assets, except for residential loans, in which case they may reach up to a maximum of 80% of such value. The loans exceeding the latter percentages are considered not *eligible* **in their totality** (*hard limits*).

> Notwithstanding above, mortgage loans that initially exceed these percentages can be used as cover assets for the issuance of CB when due to the repayment of their principals the values do not exceed said LTVs.

Additionally, and differently to the traditional rule in Spain, in case that due to the decrease of the market value of the mortgaged properties after the loans are incorporated to the pool (supervened depreciation of collaterals) LTV exceed said percentages, mortgages loans could be considered *eligible* but only up to the 60% or 80 % of their amount (*soft limit*-like solution). Notwithstanding this, these loans – although only partially *eligible* for the denominator of the OC level – are incorporated to the pool in their entirety (*i.e.*, the so named top tranche is incorporated to the pool).

V. ASSET – LIABILITY MANAGEMENT

Assets and OC

The RDL makes a rather literal transposition of art. 15 – *Coverage requirements* – of the CBD incorporating the *nominal principal*: aggregate principal amount of all cover assets of the pool must be equal or exceeds the aggregate principal amount of outstanding covered bonds.

The text also incorporates all the Directive's national discretions permitted *i.e.*, consideration of future interests (as an option for the issuer) or calculation of a lump sum for calculating expected costs related to maintenance and administration for the winding-down of the CB program.

Regarding OC, the RDL- in line with the CBD – distinguishes between legal, contractual and voluntary overcollateralization.

Legal OC is only specifically contemplated for the three types of CB subject to specific regulation (CRR compliant CB): mortgage bonds, public sector bonds and *internationalization* bonds, introducing the 5% percentage on a nominal basis pursuant to the new art 129 3 a) of the CRR. Only for the fourth category of CB – *Other* CB – a mandatory OC is not specifically envisaged.

The RDL does not introduce any cap to the contractual/voluntary OC.

Liability management

> The RDL has introduced for first time in Spain a rather complete regulation of the liability management fully aligned with the provisions of the Directive. In the previous period there was some sort of tacit consensus that the huge amount of overcollateralization (the entire portfolio of loans) made not strictly necessary a regulation of the liability management. The only liquidity mitigants contemplated were the substitution assets (liquid ones) but they were rarely employed.

Traditionally the primary method used by Spanish issuers to mitigate market and interest risk has been the natural matching. This has now rightly been reinforced by the different tools the RDL implements (all taken from the CBD).

> Firstly, RDL regulates a cover pool liquidity buffer – following closely art 16 of the CBD provisions – as main tool to deal with liquidity risk.

The liquidity buffer is to cover the maximum cumulative net liquidity outflow over the next 180 days, the RDL not extending this term.

With respect to the type of liquid assets admitted into the buffer, RDL does not restrict the list envisaged in art 16.3 of the CBD.

In case that extendable maturity structures are used the RDL determines that the final maturity date is to be considered for the calculation of the principal, incorporating so the Directive's possibility and conceding more flexibility to the issuers.

> RDL also regulates the use by issuers of derivatives contracts for mitigating risks, mainly interest risk. Here also the regulation reproduces faithfully the Directive requirements (art 11).

The hedging counterparties must be credit institutions with the specific credit quality mentioned in art 129 1 c) CRR.

RDL adequately regulates that hedging counterparties' claims have the same preference as covered bond holders in case of bankruptcy or resolution of the issuer and that when any of the latter circumstances occur derivative contracts cannot be early terminated.

> RDL also introduces extendable maturity structures that were completely unknown in Spain.

The regulation reproduces the requirements contemplated in art 17.1 of the CBD. Their effective use is a free option for the issuers always within the legal framework.

These structures will normally adopt the form of soft bullets.

With respect to the objective triggers entitling issuers for maturity extensions the RDL mentions:

> Serious liquidity problems.

> Insolvency or resolution situations.

> No viability of the credit institution according to the Recovery and Resolution Directive.

> Serious market disturbances.

Moreover, RDL requires a specific BE approval to activate the requested extension.

> RDL also obliges issuers to implement internal tests to mitigate interest rate, foreign exchange and maturity mismatch risks.

VI. TRANSPARENCY

The transparency regime that RDL lies down is a reproduction of art. 14 (*investor information*) of the CBD. The information is to be disclosed quarterly and not more frequently.

On top of that, main Spanish issuers of BG, coordinated by the Spanish Mortgage Association, and since the end of 2011, have been utilizing the ECBC Label Foundation HTT (Harmonized Transparency Template). As it is well known, the Label Foundation completed in 2022 the process to fully adapt HTT to art. 14 provisions.

VII. COVER POOL MONITOR AND BANKING SUPERVISION

Cover pool monitor

In contrast with other European legislations the institution of the CPM (*órgano de control del conjunto de cobertura*) was completely unknown in Spain being its introduction a novelty of the RDL.

Although the Directive does not make the introduction of this figure into the national legislation compulsory, Spanish legislator rightly introduced it assuming was a feature of most European legislations.

Its mission – according to the art 13.1 of the CBD – is to perform ongoing monitoring of the fulfilment by the CB issuers of all the legal requirements and limits and the RDL specifies its concrete duties.

The RDL incorporates the two alternatives permitted by the Directive for the issuers implementing this figure.

a) Appointing an external entity.

b) Configuring it as an internal CPM.

> External CPM.

The external CPM must be a commercial society with sufficient human and material resources and sound internal procedures. Qualified stakeholders (10% of the capital), directors and general managers must all be good repute.

RDL explicitly prevents from being CPM auditors having acted as such for the issuer (or a company of its group) in the three previous years to their appointment or corporations belonging to the issuer's group.

External CPM must be appointed for a minimum period of 3 years, which could be extended up to a maximum of ten years (although it could be re-appointed once 3 years have elapsed since the end of its mandate). Notwithstanding the issuer can decide to dismiss the CPM when appreciating is not fulfilling their duties correctly, notifying it to the BE and proposing a new candidate to be approved by it.

> Internal CPM.

The RDL requires that this kind of CPM has sufficient independence, *authority*, and resources within the issuer. Its appointment corresponds to the Board of Directors of the issuer to whom direct access should be permitted.

When the issuers apply for the approval of the CB program by the BE they must indicate who is the proposed (external or internal) CPM and prove that all the relevant requirements are met, corresponding in any case the final decision to the BE. The BE has a very wide margin of discretion to determine who can be effectively appointed. CPM are recorded in a special register hold by the BE. As a matter of fact, the BE has only accepted external CPM.

The RDL invests the CPM with a very wide range of powers and faculties and envisages different levels of reporting firstly to the issuer itself and subsequently to the BE to check that issuers always act correctly and prevent breaches of the legislation.

Banking Supervision

RDL confers CB public supervision to the BE giving it wide supervisory powers in line with the provisions of art.18 of the Directive.

BG issuers require a special permission from the BE for each CB program. Needed requirements to obtain the permission are basically the same as those laid down in art 19.2 of the CBD, but additionally requiring the issuers to file an impact assessment of the program on its financial situation (solvency, liquidity...) and also provide information on the risk management of the pool.

The reporting to the BE is designed with a quarterly frequency and referred to all the necessary elements to justify the correct functioning of the programs in line with art 21.2 of the CBD. The details of said reporting were established by the BE in the Circular 1/2023.

On top of this the BE can request at any moment more information through the CPM.

The RDL finally dedicates several articles to the disciplinary regime following closely arts. 23 and 24 of the CBD provisions, comprising:

> Infractions.

> Penalties and their publication.

> The disciplinary procedure applicable is the one contemplated in the credit institutions general legislation.

A "special" supervision is also carried out by the Spanish Securities Markets regulator (Comisión Nacional del Mercado de Valores) who supervises compliance with bonds' marketing and public offers rules and as well the functioning of CB secondary markets.

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

Asset segregation from the insolvency estate

As we already said above, before the RDL was approved Spanish legislation did not recognize the figure of pools of assets as such. In case of insolvency the entire mortgage (or other eligible assets) portfolio worked as collateral having bond holders a preferential right against **all** the loans whatever their characteristics were. This was the main singularity of the Spanish model of *cédulas*.

The new regulation radically changes said solution introducing for first time the idea of pool (defined set of assets) making Spanish legislation convergent with the solution adopted by all the other jurisdictions and subsequently adopted by the Directive itself.

All covered bond programs are linked to a specific pool of assets (*conjunto de cobertura*) securing the payments obligations attached to the covered bonds, being said assets duly segregated from other assets held by the credit institution.

All the assets integrating the *conjunto de cobertura* are recorded in an internal register (cover register) continuously updated.

Credit institutions must configure the register permitting the individual identification of each asset and to check its compliance with the *eligibility* requirements the RDL lies down. The RDL specifies the concrete information to be shown over each registered asset.

Effective segregation initially operates through the inclusion of the assets in the register.

Upon the insolvency of the issuer, segregation is reinforced by incorporating all the assets included in the *conjunto de cobertura* to a separate estate (*patrimonio separado*). This estate remains on the issuer's balance sheet (it is not a special purpose vehicle or similar) and is completely independent respect to the issuer (general) bankruptcy estate.

RDL supersedes general bankruptcy law and also develops general provisions contained in the resolution legislation.

One of the most positive elements of the RDL is that contains a wide and detailed procedural regulation on how insolvency or resolution of the issuer affect to the *conjunto de cobertura*.

Using the option contained in art 20.2 of the CBD the RDL has introduced the figure of the special administrator both for insolvency and resolution procedures. Their appointment corresponds to the competent (bankruptcy) judge or to the FROB (resolution authority), but the BE must be always consulted.

The special administrator is granted with a very ample range of powers on behalf of the covered bonds investors, including the faculty to assign or pledge the assets.

While insolvency or resolution procedures are open the issuer bank retains its condition of credit institution, so outstanding covered bonds keep their specific nature.

Also, according to the Directive, the Spanish regulation ensures coordination among the special administrator, the BE and the FROB.

In the case of insolvency, if at the end there is need to wind up the *patrimonio separado* since assets are clearly and definitively insufficient to pay the bond holders (default of the pool), the bonds payment shall be done on a pro rata basis, regardless of their issuance dates.

Finally, if after realizing the cover assets, bondholders' credits are not completely satisfied, they also have a right against the bankruptcy estate (recourse) but ranking *pari passu* with unsecured creditors.

On the contrary, once bondholders' claims were fully satisfied if hypothetically there were remaining assets in the *patrimonio separado*, ordinary creditors also have a right against them.

Bankruptcy remoteness

Regarding bankruptcy remoteness, the RDL clearly determines that the opening of bankruptcy or resolution procedures in no case implies the automatic acceleration of payments, explicitly excluding any entitlement to the bondholders to claim for the early payment of the debts.

IX. RISK-WEIGHTING & COMPLIANCE WITH EUROPEAN LEGISLATION

As we said in the first chapter – Framework – the RDL has carried out a complete and respectful transposition of the Covered Bond Directive as well as a correct integration of the revised CRR (art 129) provisions.

The RDL mainly regulates CRR compliant CB (mortgage bonds, public sector bonds and *internationalization* bonds) but also contemplates a fourth category "*Other covered bonds*", where bonds only must comply with art 6 of the CBD (*eligible* cover assets) requirements and which could include assets not contemplated in art. 129.1 of the CRR, with no specific determination of the assets to be fit (open category).

Issuers: ABANCA Corporación Bancaria, S.A., Banco de Sabadell, S.A., Banco Santander S.A., Bankinter, S.A., BBVA, CaixaBank SA, Caja Rural de Navarra, Credit Cooperative, Eurocaja Rural, Grupo Cooperativo Cajamar, Ibercaja Banco S.A., Kutxabank S.A., Unicaja Banco SA.

COVERED BOND · LABEL · : Banco de Sabadell, S.A. (1 pool), CaixaBank SA (2 pools), Banco Santander S.A. (2 pools), Kutxabank S.A. (1 pool), Unicaja Banco SA (1 pool), BBVA (2 pools), Bankinter, S.A. (1 pool), Ibercaja Banco S.A. (1 pool), Eurocaja Rural (1 pool), Caja Rural de Navarra, Credit Cooperative (1 pool), ABANCA Corporación Bancaria, S.A. (1 pool), Grupo Cooperativo Cajamar (2 pools).

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: