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Amendments to the regime for covered bonds

Royal Decree-law 5/2023, of 28 June ("RDL 5/2023") has amended Royal Decree-law 24/2021, of 2 November ("RDL 24/2021"), regarding covered bonds. In particular, the following amendments have been introduced:

1. The definition of "voluntary overcollateralization"

Article 10bis of RDL 24/2021 introduced by RDL 5/2023 defines "voluntary overcollateralization" as those assets assigned by the issuer to the cover pool in excess of those necessary to cover the legal overcollateralization and, where applicable, the contractual overcollateralization.

Although the issuer is only obliged to comply with the levels of legal overcollateralization and, where applicable, contractual overcollateralization to which it may commit itself, it may only use the assets voluntarily assigned to the cover pool when authorised by the cover pool monitor and provided that none of the legal or contractual requirements and limits are breached.

2. Rules for valuation of the assets included in the cover pool

New rules have been established for the valuation of the cover assets. RDL 24/2021 previously referred to the rules contained in Circular 4/2017, of 27 November, of the Bank of Spain ("Circular 4/2017"). Following the amendment, the valuation will be performed on the basis of the type of asset: (a) primary assets and short-term deposits held in credit institutions, at their nominal value; (b) liquid assets, under Commission Delegated Regulation (EU) 2015/61, of 10 October 2014; (c) short-term exposures to credit institutions and fixed-income securities, at market value; and (d) derivative financial instruments, under Circular 4/2017.

Regarding the general principles for the valuation of physical assets, a distinction is made between real estate and physical assets other than real estate.

- *Real estate*: the valuation methodology and process will be conducted under the rules contained in Circular 4/2017. The fundamental change when compared to the previous regime is the elimination of the obligation to update the valuation of the real estate at least annually (without prejudice to the updating rules provided for in the aforementioned Circular 4/2017). Under no circumstances may the value of a mortgaged property be higher than that obtained in the full individual appraisal carried out under Order ECO/805/2003 at the time of the granting of the loan or, as the case may be, lower than that which would have been included in the cover pool.
- *Physical assets other than real estate*: the valuation methodology must be carried out in accordance with generally accepted expert valuation standards that are appropriate for the physical collateral asset in question. At the time of inclusion in the cover pool of loans collateralized by physical assets of this nature, the physical assets must be valued using a report prepared by an independent expert.

Once the loan collateralized by the physical asset has been included in the cover pool, the institution must check for evidence of significant losses at least once a year. If, as a result of such a check, there is evidence of a significant loss, the valuation must be updated in a report by an independent expert.

3. Rules for the management of inflows and outflows of loans from the cover pool

The cover pool monitor is responsible for authorising inflows and outflows from the special registry of the cover pool. Article 30.3 of RDL 24/2021 contemplates three scenarios for removing assets or rights included in the cover pool (the ordinary maturity of the loan, the loss of eligibility of the asset and the replacement of the asset with another), to which two new scenarios have been added, always at the request of the issuer and with the authorisation of the cover pool monitor: (i) if as a consequence of the redemption of issued covered bonds the cover exceeds the legal or contractual overcollateralization; and (ii) if the level of overcollateralization is higher than the minimum required, legally or contractually, provided that this does not entail a breach of any of the requirements and limits imposed on the cover assets.

4. Modifications of affected loans

As a general rule, the "restructuring" (in the terms provided for in Article 23.7 of RDL 24/2021) of the loans affected by the issuance of covered bonds is subject to the express authorisation of the cover pool monitor. As a new feature, issuers are permitted to amend the terms and conditions of the affected loans, without the express authorisation of the cover pool monitor, when the origin is a mandatory rule, although they must report individually, at the time that the modifications are carried out, to the cover pool monitor, which must verify that, following such modifications, none of the requirements or limits imposed on the cover assets have been breached.

5. Rules of conduct for the ad hoc administrator when liabilities are lower than assets

An important error has been amended in Article 44.2 of RDL 24/2021, which previously provided that the liquidation of the separate assets would be requested by the ad hoc administrator if the assets were "greater" than the liabilities, which made no sense, as stated [here](#). The amendment now provides that the administrator will request the liquidation of the separate assets if the total value of the assets is less than the liabilities.

It also provides that, during the liquidation period, the separate assets will not have to meet the liquidity, overcollateralization, credit quality, size of exposures, granularity or diversification requirements.

6. Designation of the cover pool monitor and sanctioning regime

Under the new wording of Article 31.5 of RDL 24/2021, once the statement of compliance has been submitted under Article 69 of Law 39/2015, of 1 October, the Bank of Spain will register the cover pool monitor in a specific registry (the reference to express authorisation by the Bank of Spain in the aforementioned article has been removed). However, the wording of Article 36.2 of RDL 24/2021, which refers to the Bank of Spain's power to grant or refuse the authorisation of the cover pool monitor under Article 31, has been retained, raising doubts as to the need for express approval of the cover pool monitor by the Bank of Spain.

In any case, the Bank of Spain will supervise and sanction the external cover pool monitors. In this respect, the new Articles 61 bis to 61 quater introduced by RDL 5/2023 govern the sanctioning regime, infringements and sanctions in relation to the activity of the external cover pool monitor.

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