

Regulations and guidelines 2/2024

Risk management concerning mortgage bank operations

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Legal nature of regulations and guidelines

Regulations

Financial Supervisory Authority (FIN-FSA) regulations are presented under the heading 'Regulation' in FIN-FSA's regulations and guidelines. FIN-FSA regulations are binding legal requirements that must be complied with.

FIN-FSA issues regulations only by virtue of and within the limits of legal provisions that entitle it to do so.

Guidelines

FIN-FSA interpretations of the contents of laws and other binding provisions are presented under the heading 'Guideline' in FIN-FSA's regulations and guidelines.

Also recommendations and other operating guidelines that are not binding are presented under this heading, as are FIN-FSA's recommendations on compliance with international guidelines and recommendations.

The formulation of the guideline shows when it constitutes an interpretation and when it constitutes a recommendation or other operating guideline. A more detailed description of the formulation of guidelines and the legal nature of regulations and guidelines is provided on the FIN-FSA website.

[fin-fsa.fi > Regulation > Legal framework of FIN-FSA regulations and guidelines](https://fin-fsa.fi/Regulation/Regulation%20-%20Legal%20framework%20of%20FIN-FSA%20regulations%20and%20guidelines)

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1 Scope of application and definitions

1.1 Scope of application

These regulations and guidelines apply to the following supervised entities referred to in the Act on the Financial Supervisory Authority (878/2008, FIN-FSA Act):

- mortgage banks as referred to in section 5 of the Act on Mortgage Credit Banks and Covered Bonds,
- deposit banks and credit companies which have been granted authorisation by the Financial Supervisory Authority (FIN-FSA) to conduct mortgage bank operations as referred to in section 8 of the Act on Mortgage Credit Banks and Covered Bonds,

1.2 Definitions

For the purposes of these regulations and guidelines, the following terms shall have the following meanings:

- *mortgage bank* refers to a credit company established as a limited-liability company, which may not conduct other business operations than those referred to in section 5 of the Act on Mortgage Credit Banks and Covered Bonds,
- *authorised credit institution* refers to a deposit bank or credit company which has been granted authorisation by the Financial Supervisory Authority (FIN-FSA) to conduct mortgage bank operations referred to in section 8 of the Act on Mortgage Credit Banks and Covered Bonds,
- *supervised entity* refers to both a separate mortgage bank and an authorised credit institution.

2 Legal framework and international recommendations

2.1 Legislation

The following legal provisions are related to the matters addressed in these regulations and guidelines:

- Act on Mortgage Credit Banks and Covered Bonds (151/2022, hereinafter the MCBCBA)
- repealed Act on Mortgage Credit Bank Operations (688/2010, the MCBOA), in accordance with section 51 of the MCBCBA

2.2 EU Directives

The following European Union Directive relates to the matters addressed in these regulations and guidelines:

- Directive (EU) 2019/2162 of the European Parliament and of the Council on the issue of covered bonds and covered bond public supervision and amending Directives 2009/65/EC and 2014/59/EU

2.3 FIN-FSA's regulatory powers

The FIN-FSA's power to issue binding regulations on the subject is based on the following legal provisions:

- Section 24, subsection 7 of the MCBCBA: The Financial Supervisory Authority may issue further regulations on the valuation of derivatives and taking total cash flows into account when calculating cover pool total value. The Financial Supervisory Authority may also issue further regulations on the methods used to calculate and value overcollateralisation.
- Section 31, subsection 3 of the MCBCBA: The Financial Supervisory Authority may issue further regulations on the calculation of the liquidity buffer requirement.

3 Objectives

- (1) The objective of these regulations and guidelines is to guide the conduct of supervised entities as far as such guidance is not sufficiently included in the legislation.
- (2) The regulations and guidelines are necessary to protect both the public and holders of covered bonds against, among other things, the risk of losing repayable funds, and to supervise the reliability and stability of the banking system.

4 Risk management concerning mortgage bank operations

4.1 Prerequisites for mortgage bank operations and supervision of the operations

4.1.1 Business plan

- (1) In accordance with section 8, subsection 1 of the MCBCBA, a mortgage credit bank and other credit institution shall apply to the Financial Supervisory Authority for an authorisation to pursue mortgage credit bank operations. In accordance with subsection 2, paragraph 1 of said section, the FIN-FSA shall grant the authorisation if, based on the information received, it can be verified that the application contains an adequately comprehensive business plan, according to which the credit institution is capable of conducting mortgage credit bank operations in the planned extent.

The rationale of this provision (Government proposal 203/2021, p. 53) lists examples of matters that should typically be covered in the business plan from the perspective of sufficient comprehensiveness.

GUIDELINE (paragraphs 2-3)

- (2) The FIN-FSA recommends that the board of directors of the supervised entity adopts the business plan for mortgage bank operations at least on an annual basis.
- (3) The FIN-FSA recommends that the business plan covers at least the following matters:
- anticipated share of funding through covered bonds relative to total funding and the balance sheet total,
 - anticipated amount of covered bonds relative to the amount of available collateral,
 - anticipated covered bond issues, their amounts and volumes over the following year,
 - pricing expectations for covered bonds, targeted level of credit rating, target group, overcollateralisation targets, costs and intended market venues,
 - quality and composition targets of credit claims planned to be used as collateral in the cover pool and other collateral in the cover pool, and their sources,
 - categories of temporary collateral for covered bonds,
 - documentation of how the sufficiency of collateral over the life cycle of the covered bonds will be ensured,
 - principles of applying anticipated derivatives hedges,
 - use of structured issues,
 - whether the issuer is planning to pursue the issuance of covered bonds with the intermediary loan model, and if it is, a more detailed description of the intermediary loan model, indicating at least the principles and objectives of the use of intermediary credit.

4.2 Cover pool

4.2.1 Requirements concerning overcollateralisation

- (1) In accordance with section 24 of the MCBCBA, the total value of the cover pool shall continuously exceed the value of payment obligations arising from the covered bonds as provided in said section (overcollateralisation). The value of the overcollateralisation shall constantly be at least two per cent. If the requirements laid down in Article 129(3)(a)(3) of the EU Capital Requirements Regulation are not met, the overcollateralisation value shall be at minimum five per cent. In addition to the part laid down in this subsection, the overcollateralisation shall also cover the estimated winding-down costs related to covered bonds.

The overcollateralisation amount shall be determined by a calculation method based on present value. When calculating the present value, payments of loan receivables included in the cover pool shall be taken into account in the proportion in which these loan receivables are included in the calculation of the cover pool total value as referred to in section 23 above.

If the calculation method based on present value produces a higher cover pool total value than the method based on the nominal value of obligations incurred from the covered bonds, the overcollateralisation shall be determined on the basis of the nominal value.

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.

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

The same method shall be used to determine both the total value of the cover pool and the obligations incurred from the covered bonds.

The Financial Supervisory Authority may issue further regulations on the valuation of derivatives and taking total cash flows into account when calculating cover pool total value. The Financial Supervisory Authority may also issue further regulations on the methods used to calculate and value overcollateralisation.

REGULATION (paragraphs 2–3)

- (2) In both nominal and present value-based calculation, the same method based on the fair value or book value, where lower than the fair value, shall be applied to the substitution assets referred to in section 18 of the MCBCBA and assets used to cover the liquidity buffer requirement under section 31 of the MCBCBA, which is applied to the determination of the liquidity buffer requirement under section 31 of the MCBCBA.
- (3) In the valuation of short-term exposures or short-term deposits referred to in section 18, subsection 1, paragraph 2 of the MCBCBA, the book value of the exposure or deposit shall be applied.

GUIDELINE (paragraphs 4–5)

- (4) The FIN-FSA recommends that if different overcollateralisation requirements have been set for different cover pools, the supervised entity shall monitor the covercollateralisation ratio of each cover pool separately.
- (5) The FIN-FSA recommends that supervised entities assess the effect of the alternative scenarios on the overcollateralisation amount on a regular basis. It is also recommended that the effects of the alternative scenarios on the overcollateralisation amount are taken into consideration when determining the risk appetites and risk limits of the mortgage bank operations.

4.3 Bond register

- (1) In accordance with section 27 of the MCBCBA, the issuer shall keep a register of bonds issued by it and their cover pools. Any changes to the information in the bond register shall be entered in the register without delay. A record shall be kept of entries made in the register which cannot be changed subsequently. The information in the bond register shall make it possible to identify the cover pools used as collateral for bonds and the cover assets contained in the cover pools.

GUIDELINE (paragraphs 2– 3)

- (2) The FIN-FSA recommends that authorised credit institutions' bond registers should not include loans that are not included in the value of the cover pool. Exceptions to this rule may include, for example, changes of collateral, restructuring of loans or other comparable temporary reasons.
- (3) The FIN-FSA recommends that supervised entities retain records of bond register entries in accordance with the provisions of the Accounting Act (1336/1997) on the retention of accounting material.

4.4 Liquidity requirements

- (1) In accordance with section 31, subsection 1 of the MCBCBA, the issuer shall ensure that the cover pool continuously contains an amount of funds that meets the requirements laid down in section 18, subsections 1 and 2 and covers the maximum cumulative net liquidity outflow relating to covered bonds over the next 180 days (liquidity buffer requirement).
- (2) In accordance with section 31, subsection 3 of the MCBCBA, the FIN-FSA may issue further regulations on the calculation of the liquidity buffer requirement.

REGULATION (paragraph 3)

- (3) The future cash flows from variable rate contracts shall be estimated using a method that is documented in writing and approved by the board of directors of the supervised entity.

GUIDELINE (paragraph 4)

- (4) The FIN-FSA recommends that supervised entities estimate the effect of the alternative scenarios on cash flows from the contracts and maximum net outflows on a regular basis. It is also recommended that the effects of the alternative scenarios on liquidity requirements are taken into consideration when determining the risk appetites and risk limits of the mortgage bank operations.

4.4.1 Extension of covered bond maturity

- (5) In accordance with section 32, subsection 1 of the MCBCBA, the terms of a covered bond may contain a clause under which the issuer may, subject to permission granted by the Financial Supervisory Authority, extend the maturity of the covered bond. In this case, the contract terms shall meet the requirements laid down in section 32 of the MCBCBA and specify the final maturity date of the covered bond. In accordance with subsection 2 of said section, 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.
- (6) The rationale of the provision (Government proposal 203/2021, p. 70) contains a mention of the statements and explanations that should be indicated in the application.

GUIDELINE (paragraphs 7- 9)

- (7) The FIN-FSA recommends that the following matters are indicated in the documents attached to an application concerning the extension of the maturity of a covered bond:
- The covered bond has been issued in accordance with the MCBCBA, or the supervised entity has started to apply the MCBCBA, in accordance with section 51, subsection 4 of the MCBCBA to covered bonds issued under the previous Act on Mortgage Credit Bank Operations (688/2010).
 - The terms and conditions of the covered bond in their entirety.
 - Explanation of the fulfilment of the prerequisites for the extension of maturity. The explanation shall include least:
 - actions that the supervised entity has taken or sought to take in order to refinance the maturing covered bond with its customary long-term funding sources,
 - calculation indicating the impacts on the LCR ratio if the supervised entity were to repay the covered bond.
 - The new maturity date being sought for the covered bond.
 - A list of all covered bonds issued by the supervised entity and their maturity dates.
- (8) The FIN-FSA recommends that the supervised entity contacts the FIN-FSA before submitting the application.
- (9) The FIN-FSA recommends that the supervised entity submits the application electronically to the FIN-FSA's registry.

4.5 Separation of risk management concerning mortgage bank operations in the event of resolution

- (1) Section 9, subsection 3 of the MCBCBA provides on ensuring that the administration of covered bonds can be continued despite resolution procedures.

GUIDELINE (paragraph 2)

- (2) The FIN-FSA recommends that authorised credit institutions that are not mortgage banks arrange their risk management concerning mortgage bank operations as a single entity so that they have the capacity to separate them into an independent entity in the potential event of resolution.

5 Repealed regulations and guidelines

- (1) Upon their entry into force, these regulations repeal FIN-FSA regulations and guidelines 6/2012, issued on 26 July 2012 “Mortgage bank authorisation procedure and risk management”. However, in accordance with section 51 of the MCBCBA, the repealed regulations and guidelines 6/2012 shall continue to apply, even after the entry into force of these regulations and guidelines, to covered bonds referred to in section 2, subsection 5 of the repealed Act on Mortgage Credit Bank Operations (688/2010).