



---

**AN BILLE UM URRÚIS FAOI CHUMHDACH  
SÓCMHAINNE (LEASÚ) 2007  
ASSET COVERED SECURITIES (AMENDMENT) BILL 2007**

---

**EXPLANATORY MEMORANDUM**

---

**Purpose of the Bill**

The purpose of the Bill is to introduce some necessary technical changes to the Asset Covered Securities Act 2001 so as to provide greater legal clarity to, and facilitate greater flexibility when operating, some provisions of the original Act. The Bill also includes some new provisions aimed at developing the Irish covered bonds statutory and legal framework in the light of changes made in other jurisdictions or in EU legislation and introduces a new kind of designated credit institution (a designated commercial mortgage credit institution) whose activities will be focused on commercial mortgage lending.

**Provisions of the Bill**

*Section 1* is a section defining the Asset Covered Securities Act 2001 as the Principal Act.

*Section 2* is an interpretation section, providing for the amendment of certain definitions in section 3 of the Principal Act and the inclusion of additional definitions.

*Section 3* amends section 4 of the Principal Act to include a new provision permitting securitised mortgage credit; to allow a designated mortgage credit institution treat certain residential property as commercial property (e.g. an apartment block run as a business or a residential/commercial mix); and to make provision for types of security interests over property outside the State which qualify for the purposes of section 4(1).

*Section 4* amends section 5 of the Principal Act by incorporating the new public sector covered bond criteria in the Capital Requirements Directive (defined, for the purposes of the Bill, as the Codified Banking Directive) and to add New Zealand and Australia to the list of non-EEA entities whose assets may be included in a cover assets pool.

The amendment also allows the inclusion in the public sector loan cover assets pool of debt instruments of highly-rated multilateral development banks and international organisations, in line with the new Capital Requirements Directive's provisions. It also permits an

asset which is a public credit in part only to be treated as a public credit asset but ignoring for financial matching and over-collateralisation purposes the non-public credit part of the asset.

*Section 5* amends section 6 of the Principal Act so as to ensure that pool hedge collateral is not treated as a substitution asset.

*Section 6* amends section 11 of the Principal Act and requires the Minister to consult with the Authority before imposing additional functions on the Authority.

*Section 7* amends section 12 of the Principal Act by including unauthorised activities in relation to designated commercial mortgage credit institutions and commercial mortgage covered securities as an offence under the Act.

*Section 8* amends section 13 of the Principal Act to allow applications for registration as a designated commercial mortgage credit institution to be made to the Authority and to confirm that the same person can apply for registration as more than one kind of designated credit institution.

*Section 9* amends section 14 of the Principal Act to allow the Authority to register designated commercial mortgage credit institutions if they meet certain conditions and to issue the successful applicants with a certificate of registration, containing any conditions attached to registration.

The amendment also provides for notification by the Authority of designated commercial mortgage credit institutions to the Revenue Commissioners.

*Section 10* amends section 15 of the Principal Act and provides that registration as a designated commercial mortgage credit institution authorises the holder of the registration to carry on business as a designated commercial mortgage credit institution in accordance with the Act.

The amendment also prevents a designated credit institution acting as another type of designated credit institution unless it is also registered under the Act as that other type of designated credit institution.

*Section 11* amends section 16 of the Principal Act to ensure that the Authority has the power to vary a condition of registration in respect of a designated commercial mortgage credit institution.

The amendment also provides that the Authority may vary or impose conditions to ensure compliance with the new Capital Requirements Directive or other relevant EU directive or regulation as regards covered bonds.

*Section 12* amends section 17 of the Principal Act to require the Authority to establish a register of designated commercial mortgage credit institutions and to make provision for what particulars must be contained in the register of designated commercial mortgage credit institutions.

*Section 13* amends section 18 of the Principal Act to allow for voluntary de-registration of designated commercial mortgage credit institutions.

*Section 14* amends section 21 of the Principal Act clarifying that section 21 is not intended to place the Financial Regulator in the position of adjudicating upon the contractual obligations of the credit institutions.

*Section 15* amends section 22 of the Principal Act clarifying that directions from the Authority are given under section 20 or 21 of the Principal Act.

*Section 16* amends section 25 of the Principal Act to reflect that ACC Bank plc is no longer a separate class of credit institution as it is now covered by section 3(1) of the Act as a licensed bank.

*Section 17* amends section 27 of the Principal Act to permit a designated mortgage credit institution to provide mortgage-related trust services to members of its corporate group in certain circumstances. These services involve the institution holding mortgage related security on trust for other group lenders so that they can avail of that security as well as the institution. The amendment also prevents loan assets held by other group members where the related security is held by a designated mortgage credit institution as a result of its provision of group mortgage trust services to group entities from being included in its cover assets pool and to disapply section 31(1) in the case of such assets. The provision also requires claims under loans held by the institution to have priority over claims under loans held by other group members in terms of recourse to the related security.

This section includes technical amendments to prevent overlaps in the classification of asset types and clarify that a designated mortgage credit institution can only issue mortgage covered securities.

Finally, the amendment will allow a designated mortgage credit institution (DCI) to hold pool hedge collateral as a separate asset class. It is often necessary for DCIs to put hedging contracts in place to manage the risk of fluctuations in interest rates and foreign currencies or credit risks, resulting in better risk management. Under these hedging contracts, the hedge counterparty may be required in certain circumstances to post collateral with the institution to support that counterparty's obligations under the hedge. This amendment will allow DCIs to deal in and hold pool hedge collateral, which will be maintained separately from the Cover Assets Pool.

*Section 18* amends section 28 of the Principal Act to provide that an institution that is also registered as a different type of designated credit institution may carry on business activities that can be lawfully carried on by such a designated credit institution.

*Section 19* amends section 30 of the Principal Act to allow for the regulation of contracts relating to hedge pool collateral and to permit cover assets hedge contracts to relate to mortgage covered securities or mortgage credit assets/substitution assets comprised in the cover assets pool, and to clarify that a cover hedge contract may consist of several transactions.

It also provides for a register of pool hedge collateral and sets out powers of the Authority with regard to it.

*Section 20* amends section 32 of the Principal Act to clarify that the asset/liability matching requirements do not apply to pool hedge collateral. Also, the definition of "duration" in the 2001 Act required modification and this is now being addressed.

The section also provides for more frequent property valuations in accordance with the requirements of the new Capital Requirements Directive.

Mandatory overcollateralisation of a minimum of 3% of the cover assets pools of designated mortgage credit institutions is introduced, but the statutory requirement does not affect any higher existing contractual overcollateralisation levels.

*Section 21* amends section 33 of the Principal Act to delete the existing aggregate 15% limit in a cover assets pool in respect of mortgage credit assets or substitution assets located in the USA, Canada, Australia, New Zealand, Switzerland or Japan in line with developments under the Capital Requirements Directive. It also restricts the inclusion of assets in a mortgage sector cover pool to those located in the EEA and category A countries.

The section also provides that if a mortgage loan is secured on a property that is in the course of development, the inclusion of that loan in the cover assets pool should be permitted, provided that the loan is attributed a nil value for financial matching and overcollateralisation purposes.

*Section 22* amends section 34 of the Principal Act to extend the duty of a designated mortgage credit institution to remedy any failure to comply with the new section 32(15) (mandatory overcollateralisation requirement) and due to the deletion of sections 33(2) and (3).

The section also requires a mortgage credit institution to remove mortgage credit assets or substitution assets from its cover assets pool once they cease to have rating levels required by the new Capital Requirements Directive.

*Section 23* amends section 35 of the Principal Act to incorporate the new pool eligibility criteria for substitution assets set out in the new Capital Requirements Directive. This also involves reducing the Irish limit of 20% on a pool asset basis to 15% on a covered bonds outstanding basis.

*Section 24* amends section 36 of the Principal Act to reflect the new definition of “include” set out in section 3 of the Act.

*Section 25* amends section 38 of the Principal Act to make the terms consistent with the new section 30(14) and to adapt section 38(7) to include designated commercial mortgage credit institutions in the obligation to keep a separate register of mortgage covered securities business.

*Section 26* inserts a new section 39A into the Principal Act to allow for a cover assets pool of a designated mortgage credit institution which contains cover assets that meet minimum matching and overcollateralisation levels to contain additional assets that do not meet restrictions on additional assets in the cover assets pool. It provides that the provisions of the Principal Act which impose limits or criteria on the cover assets contained in the pool only apply to the minimum level of those assets which are required by the Act to be maintained in the pool and not to additional assets in the pool

*Section 27* amends section 40 of the Principal Act which concerns financial statements to clarify that subsection 1(c) applies to mortgage credit assets and substitution assets. The current reference to

cover assets pools is capable of extending to cover assets hedge contracts which do not have a principal amount. Hence the restriction in 40(1)(c) to mortgage credit assets and substitution assets, which have principal amounts.

Furthermore, the amendment limits disclosure of defaulting loans to those three months or more in arrears in line with market convention. It also distinguishes commercial property from residential property in paragraph 40(2)(h) so as to ensure that the relevant disclosure is only applicable to loans secured only on commercial property.

*Section 28* amends section 41 of the Principal Act which concerns the valuation of assets or properties to clarify that the Authority has flexibility to specify different requirements for different assets or properties under section 41.

*Section 29* inserts a new section 41A to make provision for the inclusion of residential and commercial mortgage-backed securities (i.e. securitised mortgage loans) in the cover assets pool. This is being done in a way that will meet the requirements of the new Capital Requirements Directive in this regard.

*Section 30* inserts a new Chapter 1A and section 41B to adapt provisions of the Act concerning the issue of asset covered securities by designated mortgage credit institutions so that they may be applicable to designated commercial mortgage credit institutions and to include new provisions applicable to them where provisions in the Act applicable to designated mortgage credit institutions cannot be adapted to them. For instance, the statutory mandatory overcollateralisation requirement is 10% in the case of commercial mortgage loan pools (v-a-v 3% in the case of residential property).

*Section 31* amends section 42 of the Principal Act to allow a designated public credit institution to finance all its permitted activities and to allow a designated public credit institution to hold pool hedge collateral as a separate asset class. This provision allows designated public credit institutions to deal in and hold pool hedge collateral, which will be maintained separately from the Covers Asset Pool.

The section also clarifies that a designated public credit institution can only issue public credit covered securities and contains a technical amendment to prevent an overlap between credit transaction assets and assets referred to at section 42(1)(c) and (f).

*Section 32* amends section 43 of the Principal Act to clarify that an institution that is also a different kind of designated credit institution may carry on business activities that can lawfully be carried on by such an institution.

*Section 33* amends section 45 of the Principal Act to extend the Authority's powers under section 45(2) regarding the kind of hedging contracts that a designated public credit institution may enter into and the terms and conditions of such contracts in relation to pool hedge collateral.

The provision also permits cover asset hedge contracts to relate to public credit covered securities or public credit assets/substitution assets comprised in the cover assets pool: and specifies the appropriate type of securities. It also clarifies that a cover hedge contract may consist of several transactions.

Furthermore, it provides for the establishment of a register of pool hedge collateral and sets out the powers of the Authority with regard to it.

*Section 34* amends section 46 of the Principal Act to discontinue current provisions which restrict the level of public credit covered securities to fifty times the institution's own funds level. This is linked to the changes included in the new Capital Requirements Directive as regards the risk weightings of public sector loans.

*Section 35* amends section 47 of the Principal Act regarding the cover assets pool to be maintained by a designated public credit institution. The section clarifies that the requirement for asset/liability matching does not apply to pool hedge collateral and also modifies the definition of duration.

The provision also introduces mandatory overcollateralisation of cover asset pools of designated public credit institutions of a minimum of 3% and preserves existing contractual overcollateralisation levels where they are at higher levels.

*Section 36* substitutes a new section 48 of the Principal Act outlining the new pool eligibility criteria for certain public credit assets as set out in the new Capital Requirements Directive.

*Section 37* amends section 49 of the Principal Act to extend the duty of a designated public credit institution to remedy any failure to comply with the new section 47(11) mandatory overcollateralisation requirement.

The provision also requires a designated public credit institution to remove public credit assets or substitution assets from its cover assets pool once they cease to have rating levels required by the Capital Requirements Directive.

*Section 38* amends section 50 of the Principal Act to incorporate the new pool eligibility criteria for substitution assets set out in the Capital Requirements Directive.

*Section 39* in addition to other sections amends section 51 of the Principal Act to reflect the new definition of 'include'.

*Section 40* amends section 53 of the Principal Act to ensure that the terms of this section are consistent with the new section 45(14).

*Section 41* inserts a new section 54A into the Principal Act to allow for a cover assets pool of a designated public credit institution which contains cover assets that meet minimum matching and overcollateralisation levels to contain additional assets that do not meet restrictions on levels of assets in the cover assets pool. (See s. 26 of Bill above in relation to designated mortgage credit institutions.)

*Section 42* amends section 55 of the Principal Act to provide for disclosure in financial statements of details of public credit assets, which qualify under section 5(1)(d) (international organisations or multilateral development banks) and some technical amendments.

*Section 43* amends section 56 of the Principal Act to deal with amortisation of public credit assets in the cover assets pool whereby their principal amount may reduce while in the cover assets pool.



*Section 44* confirms that section 58 of the Principal Act is facilitative and not mandatory. Section 58 allowed business/asset transfer under a scheme along the lines of Part III of the Central Bank Act 1971. Some of the language in section 58 has a mandatory slant and there was a concern that it might be read as requiring any asset/business transfer to be under a section 58 scheme. As trading entities, it must be open to all DCIs to use any means of transfer assets of business permitted by law, in addition to a section 58 scheme. The amendment clarifies that point.

*Section 45* amends section 61 of the Principal Act to extend the duties of the cover-assets monitor to monitor a designated mortgage credit institution's compliance with the new section 32(15) (mandatory overcollateralisation requirement) and new provisions related to pool eligibility of securitised mortgage credit in section 41A.

*Section 46* amends section 62 of the Principal Act to extend the duties of the cover-assets monitor to monitor a designated public credit institution's compliance with the new section 47(11) (mandatory overcollateralisation requirement).

*Section 47* amends section 66 of the Principal Act to provide for a prescribed period for notifying the cover-assets monitor in relation to any failure in regard to an obligation concerning a cover assets hedge contract.

*Section 48* amends section 71 of the Principal Act to correct a typographical error.

*Section 49* amends section 72 of the Principal Act so as to include, with respect to managers, a similar provision that exists with respect to cover-assets monitors under section 68(2) and (3). The provision also enables a manager to appoint agents abroad where a designated credit institution has assets located abroad.

*Section 50* amends section 78 of the Principal Act so as to make a consequential change owing to the insertion of the new section 72(6).

*Section 51* amends section 81 of the Principal Act to extend the protection under Part 7 to security provided for cover assets and pool hedge collateral provided under cover assets hedge contracts.

*Section 52* amends section 83 of the Principal Act to correct drafting an error in the original Act.

*Section 53* amends section 85 of the Principal Act to reflect the new definition of "include" set out in section 3 of the Act.

*Section 54* amends section 88 of the Principal Act to extend the section to formerly designated credit institutions and to allow foreign mandatory claims and administration/enforcement costs to rank ahead of the preferred creditors under the Act where there is a security interest over foreign assets augmenting the statutory preference under the Act.

This section also permits security over non-Irish mortgage credit assets to be held by a security trustee and to treat the claims of such a security trustee as claims of a super-preferred creditor under the Act and to permit a cover-assets monitor or a manager to enter into arrangements with the trustee or other representative in connection with their respective functions under the Act.

*Section 55* in addition to other sections amends section 89 of the Principal Act to reflect the new definition of “include”.

*Section 56* adapts section 90 of the Principal Act concerning provisions applicable to more than one kind of designated credit institution to cater for designated commercial mortgage credit institutions. Section 90 provides that the rights of the holder of securities are secured only on the relevant cover assets pool where there is more than one kind of designated public credit institution.

*Section 57* amends section 91 of the Principal Act to include a provision to permit the Authority to implement the requirements of the new Capital Requirements Directive (defined for the purposes of the Asset Covered Securities Act as the Codified Banking Directive) in relation to covered bonds. The section also includes some typographical amendments and deletes certain sections due to possible *ultra vires* concerns.

*Section 58* inserts, for the avoidance of doubt, a new section 95A into the Principal Act which states the principles or policies which the Minister or the Authority should have regard to when making secondary legislation under the Act.

*Section 59* inserts a new section 107 into the Principal Act permitting the Minister to appoint a date for the purposes of Part 1, 2, 3 and Schedule 3.

*Section 60* inserts a new Schedule 3 into the Principal Act to delete some obsolete terms such as references in the Act to tier 1 and tier 2 assets and the definitions of European Central Bank and national central bank. These changes reflect the new Capital Requirements Directive provisions and recent changes in collateral asset categories at the European Central Bank.

*Section 61* contains the details on the short title, construction, collective citation and commencement of the Act.

#### *Financial implications*

The Bill will not give rise to any additional costs to the Exchequer.

*An Roinn Airgeadais  
Feabhra 2007.*