Ordinance No 42
of the BNB
of 21 June 2022
on the Terms and Procedure for Issuance of Covered Bonds

(published in the Darjaven Vestnik, issue 49 of 30 June 2022, effective as of 8 July 2022)

Chapter One

GENERAL PROVISIONS

Article 1. This Ordinance shall establish the requirements relating to:

1. calculation of the amount of covered bond liabilities and cover assets under the Law on Covered Bonds (LCB);
2. periodic stress tests of the cover assets;
3. documents required for selection of a cover pool monitor;
4. insurance of the cover pool monitor.

Chapter Two

CALCULATION OF THE AMOUNT OF COVERED BOND LIABILITIES AND COVER ASSETS

Article 2. In submitting an application for a covered bond issue or programme permit, the issuing bank shall provide the BNB with information on all present and future liabilities and cash claims on eligible cover assets for each individual issue of covered bonds in accordance with the requirements of Article 26 of the LCB.

Article 3. (1) Valuation of the cover assets whose value is used for calculating the degree of coverage, overcollateralisation and liquidity of an issue of covered bonds shall be effected in accordance with applicable accounting standards and Article 6 of the LCB, and of derivative contracts, in accordance with Article 4.

(2) In preparing a valuation of a tangible asset – immovable property, a comparative approach, an income approach and an expenditure approach shall apply along with the main methods belonging to them.

(3) The independent valuers under Article 6, paragraph 3 of the LCB shall not be involved in the sale or renting of relevant assets which will be included in the cover pool.

(4) The issuing bank shall have a reliable risk management framework allowing comprehensive management, identification, assessment, control and monitoring of

all direct and indirect risks, such as market risk, including interest rate and foreign exchange risks, credit and liquidity risks, as well as all other risks relevant to the cover pool.

Article 4. Valuation of the derivative contracts which are included in the cover pool pursuant to Article 10 of the LCB shall be effected in compliance with the following principles:

1. derivative contracts are involved in implementation of the coverage requirements under Chapter Three of the LCB at their fair value so that:

a) a positive fair value of a derivative contract is added to the total nominal amount of the cover assets;

b) a negative fair value of a derivative contract is not added to the total nominal amount of the cover assets but increases the total amount of the debt on a covered bond issue which shall be entirely secured by the cover assets;

2. foreign exchange and interest rate risks of each individual cover asset shall be subject to hedging by one or a combination of several derivative contracts, while complying with the following conditions:

a) in case of one derivative contract, its current exposure is calculated, and in case of more than one derivative contract, their current net exposure regarding each asset for which such a contract/contracts are available;

b) the exposure under derivative contracts provided for in letter ‘a’ is measured at market prices (the mark-to-market priciple);

c) the exposure under a derivative contract or derivative contracts for each individual hedged asset shall not at any time exceed the sum of its residual value and the net current value of cash flows to be generated until the asset is part of the coverage;

d) where the condition under letter ‘c’ is no longer met, there shall be reduction or termination in compliance with the specifications of the exposure so that the condition will be met;

3. derivative contracts are involved in implementation of the liquidity requirements under Chapter Three of the LCB so that claims and/or liabilities stemming from them are part of the inflows and/or outflows of covered bonds and are calculated at nominal value;

4. in case that over the next 180 days the outflow of a covered bond issue exceeds on a daily basis the inflow in the cover pool, additional assets shall be added, including eligible derivative contracts so that all present and future covered bond liabilities will be secured by cash claims on eligible cover assets under the LCB.

Chapter Three

PERIODIC STRESS TESTING

Article 5. (1) An issuing bank shall conduct periodic stress tests of the cover pool and liquidity management in accordance with the requirements of Article 44 of the LCB.

(2) Stress tests shall be conducted in line with an internal methodology developed by the issuing bank based on consistent, documented and verifiable criteria, assumptions and procedures, as well as in compliance with the requirements of Regulation (EU) No 575/2013.

(3) When conducting stress tests, the impact of the relevant risk reducing factors, including derivative contracts and other agreements with the same effect, shall be taken into account. Derivative contracts shall be valued at their fair value.

Article 6. (1) Where, during the stress test, the cover pool's value falls below the coverage requirements of the outstanding nominal value of the covered bond issue provided for in the LCB, the covered assets in the cover register shall be increased by an amount not less than the maximum value of the shortfall established as a result of the stress test within a period of one month.

(2) The issuing bank shall notify the BNB at least once a year of the results of the conducted stress tests. The Bulgarian National Bank may request information on the results of higher frequency stress tests, when applying a more conservative assumption or taking into account additional facts and circumstances relevant to the cover pool assessment.

Chapter Four
COVER POOL MONITOR

Article 7. (1) A cover pool monitor may be a bank licensed in the Republic of Bulgaria or in another Member State, or an audit firm under the Law on the Independent Financial Audit. Where a cover pool monitor is an audit firm, the issuing bank shall in advance coordinate its choice with the BNB in compliance with the criteria set out in Article 76, paragraph 4 of the Law on Credit Institutions.

2. The issuing bank shall submit a written application to the BNB for the selection of a cover pool monitor. The application shall contain the name, registered office and head office addresses of the applicant and the cover pool monitor, information on the covered bond programme, on each issue, respectively, which is not part of a programme for which the cover pool monitor has been appointed, and the details of the contact person with the applicant and the cover pool monitor.

(3) The following documents shall be enclosed to the application under paragraph 1:

1. declarations under Article 32, paragraph 3 of the LCB;
2. an insurance contract or another equivalent document confirming the existence of insurance with an insured amount as specified in Article 8 for the period during which the cover pool monitor performs its functions;
3. a declaration that the information submitted with the application and the documents attached to it are up-to-date, complete and reliable.

Chapter Five

COVER POOL MONITOR INSURANCE

Article 8. (1) The minimum insurance amount under the compulsory insurance for the cover pool monitor shall be BGN 250,000 for each insured event and BGN 1,000,000 for all insured events for one year.

(2) Where the cover pool monitor is an audit firm, which has concluded a compulsory professional liability insurance in compliance with the requirements of the Law on the Independent Financial Audit, the minimum amount of which is in accordance with paragraph 1 and provides coverage of the damages that may occur as a result of cover pool monitor's failure to perform its obligations, it shall be exempted from the compulsory insurance under Article 32, paragraph 5 of the LCB.

(3) The minimum insurance sum under the compulsory insurance for the special administrator referred to in Article 51 of the LCB shall be in the amount specified in Article 12a, paragraph 1 of the Law on Bank Bankruptcy.

TRANSITIONAL AND FINAL PROVISIONS

§ 1. This Ordinance is issued on the grounds of Article 26, paragraph 6, Article 32, paragraph 5 and Article 44, paragraph 5 in connection with § 4 of the Transitional and Final Provisions of the Law on Covered Bonds and adopted by Resolution No 215 of 21 June 2022 of the Governing Council of the Bulgarian National Bank and shall enter into force on 8 July 2022.

§ 2. The Deputy Governor of the Bulgarian National Bank heading the Banking Department may issue instructions on the enactment of this Ordinance.