



HM Treasury, 1 Horse Guards Road, London, SW1A 2HQ

Sir William Cash
Chair
European Scrutiny Committee
14 Tothill Street
House of Commons
London
SW1H 9NB

6 August 2018

Dear Sir Bill,

7064/18: Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on the issue of covered bonds and covered bond public supervision and amending Directive 2009/65/EC and Directive 2014/59/EU

7066/18: Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds

Thank you for your report dated 25 April on the EU covered bonds proposal, following our Explanatory Memorandum of 11 April 2018.

The Council negotiations regarding the proposed EU covered bonds framework are ongoing under the Austrian Presidency. The proposed framework is based on a set of minimum standards, building on domestic covered bond regimes and aligning them to best practices. Whilst there is some room for further clarification and work in the provisions, in the interest of preventing disruption of well-functioning national markets across the EU, we are supportive of the minimum-harmonising principle-based framework. The UK's Regulated Covered Bonds programme is well aligned to the Commission's proposal and we will continue to ensure that the UK's interests are represented in negotiations.

On the issue of third country equivalence, the Government welcomes the Commission's openness to developing a third country regime in the future. We are engaging to ensure that an introduction of an equivalence framework would operate effectively. We would also note that the International Capital Market Association's Covered Bond Investor Council (CBIC)'s response to the proposal calls to reduce the amount of time before the Commission's report on equivalence is submitted, from three to two years.

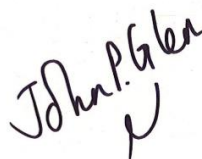
Expanding the scope of the existing equivalence framework to include activity not currently covered is a core pillar of the economic and regulatory arrangement we have proposed in the White Paper on the UK's future relationship with the EU on 12 July, in addition to a bilateral treaty underpinning the workings of this relationship.

We have made clear that equivalence as it exists today is not suitable as the basis for the future relationship between the EU and UK in FS. Indeed, current legislative proposals only deal with discrete parts of specific equivalence provisions rather than the wider financial services sector. For that reason, it is important for us to continue to engage on them to avoid any diminution of the value of equivalence in those specific areas which they apply, but also, it highlights that the only way to achieve a suitable outcome at a sector-wide level is through detailed negotiation at a bilateral level.

On your question on the volume of UK-issued covered bonds held by investors elsewhere in the EU, approximately €70 to €80 billion of outstanding UK covered bonds are held by EU buyers that are not located in the UK. This includes non-bank investors who are not required to hold capital against their covered bonds and therefore would not be affected once UK covered bonds lose their preferential prudential treatment in the EU. It is important to note that the Commission's proposals would grandfather existing covered bonds until the Directive comes into force, and UK covered bonds would continue to be able to be sold into the EU after this date even in the absence of an equivalence framework, albeit with increased costs for EU bank investors.

Discussions in Council have progressed steadily and we will continue to update the Committee throughout the negotiations. The European Parliament will soon begin its formal consideration of the proposal, with Bernd Lucke (the ECR Rapporteur) and the rest of the Economic and Monetary Affairs Committee expected to begin work in the Autumn. This work on the proposal is currently ongoing with a view to reach an agreement by the end of the year.

I am writing in similar terms to Lord Boswell of Aynho, Chair of the House of Lords European Union Committee; and copying this letter to Lynn Gardner, Clerk to the Commons Committee; Chris Johnson, Clerk to the Lords Committee; Matthew Manning, Clerk to the Lords Financial Affairs Subcommittee; Les Saunders, Department for Exiting the EU; Frances Milsom and Barbara Armstrong, HM Treasury.

A handwritten signature in black ink that reads "John P. Glen" with a stylized flourish underneath.

JOHN GLEN
ECONOMIC SECRETARY TO THE TREASURY

