



*Committee on Legal Affairs
The Chair*

20.3.2019

Mr Roberto Gualtieri
Chair
Committee on Economic and Monetary Affairs
BRUSSELS

Subject: Opinion on the legal basis of the 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(COM(2018)0094 – C8-0113/2018 – 2018/0043(COD))

Dear Mr Chair,

By letter of 4 March 2019 you asked the Committee on Legal Affairs to provide an opinion, pursuant to Rule 39 of the Rules of Procedure, on the appropriateness of a modification to the legal basis of the above proposal from the Commission.

The committee considered the above question at its meeting of 18 March 2019.

I - Background

The proposal aims at specifying the core elements of covered bonds and at providing a common definition as a consistent and sufficiently detailed point of reference for prudential regulation purposes, applicable across financial sectors. This would be done by establishing the structural features of the instrument, a covered bond specific public supervision, rules allowing use of the ‘European Covered Bonds’ label and competent authorities’ publication obligations in the field of covered bonds.

The legal basis of the proposal as presented by the Commission was Article 53 and Article 114 of Treaty on the Functioning of the European Union (TFEU).

Following the negotiations on the dossier the Council proposed to delete Article 53 TFEU on the right of establishment.

The remaining legal basis would thus consist only of Article 114 TFEU, which is the general legal basis concerning measures for the harmonisation of Member States' legislation in the internal market.

II - Relevant Treaty Articles

Article 114 TFEU, on harmonisation in the internal market, has the following wording:

Article 114 (ex Article 95 TEC)

- 1. Save where otherwise provided in the Treaties, the following provisions shall apply for the achievement of the objectives set out in Article 26. The European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, adopt the measures for the approximation of the provisions laid down by law, regulation or administrative action in Member States which have as their object the establishment and functioning of the internal market.*
- 2. Paragraph 1 shall not apply to fiscal provisions, to those relating to the free movement of persons nor to those relating to the rights and interests of employed persons.*
- 3. The Commission, in its proposals envisaged in paragraph 1 concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection, taking account in particular of any new development based on scientific facts. Within their respective powers, the European Parliament and the Council will also seek to achieve this objective.*
- 4. If, after the adoption of a harmonisation measure by the European Parliament and the Council, by the Council or by the Commission, a Member State deems it necessary to maintain national provisions on grounds of major needs referred to in Article 36, or relating to the protection of the environment or the working environment, it shall notify the Commission of these provisions as well as the grounds for maintaining them.*
- 5. Moreover, without prejudice to paragraph 4, if, after the adoption of a harmonisation measure by the European Parliament and the Council, by the Council or by the Commission, a Member State deems it necessary to introduce national provisions based on new scientific evidence relating to the protection of the environment or the working environment on grounds of a problem specific to that Member State arising after the adoption of the harmonisation measure, it shall notify the Commission of the envisaged provisions as well as the grounds for introducing them.*
- 6. The Commission shall, within six months of the notifications as referred to in paragraphs 4 and 5, approve or reject the national provisions involved*

after having verified whether or not they are a means of arbitrary discrimination or a disguised restriction on trade between Member States and whether or not they shall constitute an obstacle to the functioning of the internal market.

In the absence of a decision by the Commission within this period the national provisions referred to in paragraphs 4 and 5 shall be deemed to have been approved.

When justified by the complexity of the matter and in the absence of danger for human health, the Commission may notify the Member State concerned that the period referred to in this paragraph may be extended for a further period of up to six months.

7. When, pursuant to paragraph 6, a Member State is authorised to maintain or introduce national provisions derogating from a harmonisation measure, the Commission shall immediately examine whether to propose an adaptation to that measure.

Article 53 TFEU, which is found in the chapter on the right of establishment under the title on the free movement of persons, services and capital, has the following wording:

Article 53
(ex Article 47 TEC)

1. In order to make it easier for persons to take up and pursue activities as self-employed persons, the European Parliament and the Council shall, acting in accordance with the ordinary legislative procedure, issue directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications and for the coordination of the provisions laid down by law, regulation or administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons.

2. In the case of the medical and allied and pharmaceutical professions, the progressive abolition of restrictions shall be dependent upon coordination of the conditions for their exercise in the various Member States.

III - Case-law on legal basis

It is settled case law of the Court of Justice that "the choice of legal basis for a Community measure must rest on objective factors amenable to judicial review, which include in particular the aim and content of the measure"¹. The choice of an incorrect legal basis may therefore justify the annulment of the act in question.

¹ Case C-45/86, *Commission v. Council* (Generalised Tariff Preferences) [1987] ECR 1439, para. 5; Case C-440/05 *Commission v. Council* [2007] ECR I-9097; Case C-411/06 *Commission v. Parliament and Council* [2009] ECR I-7585.

When it comes to multiple bases it has to be established whether the proposal either:

1. pursues multifold purposes or has multifold components, and one of those is identifiable as the main or predominant purpose or component, whereas the others are merely incidental; or
2. simultaneously pursues a number of objectives or has several components that are indissociably linked, without one being secondary and indirect in relation to the other.

According to the case law of the Court of Justice, in the first case the act must be based on a single legal basis, namely that required by the main or predominant purpose or component, and in the second case the act will have to be founded on the various corresponding legal bases.²

IV - Aim and content of the proposed directive

Covered bonds are debt obligations issued by credit institutions and secured against a ring-fenced pool of assets to which bondholders have direct recourse as preferred creditors. At the same time, bondholders remain entitled to claim against the issuing entity as ordinary creditors. Covered bonds are issued by credit institutions and are a reliable and stable funding source for European banks.

According to the explanatory memorandum of the proposal, the Directive would set out principles-based requirements governing the administration of covered bond programmes in cases of insolvency/resolution of the issuer. The proposal is not intended to harmonise national insolvency regimes nor change the treatment of covered bonds in cases of resolution under Directive 2014/59/EU (Bank Recovery and Resolution Directive). On the contrary, it keeps detailed provisions to the minimum required to ensure that a set of common basic structural rules applies across the single market. Member States will have a degree of freedom in formulating their own laws to transpose the principles set out in the Directive.

A Union legislative framework on covered bonds should expand the capacity of credit institutions to provide financing to the real economy and contribute to the development of covered bonds across the Union, particularly in Member States where no market for them currently exists.

The Commission's purpose is to ensure that covered bonds have similar structural characteristics across the Union that make them coherent with the relevant prudential requirements. The harmonisation of covered bonds is therefore in line with the Commission's aim of financial stability, as pursued in its regulation of financial markets.

The proposal consists of 40 recitals and 34 articles, divided under six titles on subject matter, scope and definitions, structural features of covered bonds, covered bond public supervision, labelling, amendments to other directives and final provisions. The title on structural features on covered bonds in turn consists of two chapters, on dual recourse and bankruptcy remoteness and cover pool and coverage, with the latter being further divided into two sections: on eligible assets and coverage and liquidity requirements.

² See the Case C-411/06, cited above, paras 46-47.

This general structure of the directive is maintained in the negotiated text, only three new recitals have been added, and the amendments to the articles have been made directly therein without the addition of any completely new articles.

Recital 4 as amended in the provisional agreement sets out that there is a lack of harmonisation across the Union regarding the conditions for the issue of covered bonds and that differences between national frameworks or the absence of such a framework, together with the lack of a commonly agreed definition of covered bonds, could create obstacles to the development of a truly integrated single market for covered bonds.

Recital 5 goes on to say that the harmonisation of certain aspects of national regimes alongside identified best practices should therefore ensure a smooth and continuous development of well-functioning covered bond markets in the Union and limit potential risks and vulnerabilities to financial stability.

Recital 9 refers to a report by the European Banking Authority (EBA)³ to the European Systemic Risk Board (ESRB), the Council and the Commission which concluded that further harmonisation is necessary to ensure more consistent definitions and regulatory treatment of covered bonds in the Union and that such harmonisation should build on the existing well-functioning markets in some Member States.

Article 28 amends Directive 2009/65/EC⁴, which was based on Article 47 TEC, the predecessor to Article 53 TFEU, and Article 29 amends Directive 2014/59/EU⁵, which was based on Article 114 TFEU.

The proposed Directive was furthermore presented in a package together with a proposal for a regulation on exposures in the form of covered bonds⁶, which is also based on Article 114 TFEU.

V - Determination of the appropriate legal basis

It follows from the analysis of the proposal that the Directive deals with the functioning of covered bond markets as part of the general legislation on the functioning of financial markets. The Directive falls thus within the scope of Article 114 TFEU, which allows the adoption of measures for the approximation of national provisions which have as their object the establishment and functioning of the internal market.

With regard to Article 53 TFEU, firstly, it is worth noting that no mention of this provision

³ EBA Report on covered bonds - Recommendations on harmonisation of covered bond frameworks in the EU (2016), EBA-Op-2016-23.

⁴ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

⁵ Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms (OJ L 173, 12.6.2014, p. 190).

⁶ Proposal for a Regulation on amending Regulation (EU) No 575/2013 as regards exposures in the form of covered bonds (COM(2018)0093).

appears in the text of the proposal, not even in the specific section of the explanatory memorandum to the proposal concerning the choice of legal basis, nor an explanation of the appropriateness of its insertion. Article 53 TFEU is only referenced in the proposal indirectly given that one of the directives amended by the proposed directive was based on the predecessor to that article.

Secondly, as pointed out by the Legal Service⁷, Article 53 TFEU was added as a legal basis because of Article 19 of the proposal, entitled *Permission for covered bond programmes*. This provision foresees the need of a permission to be obtained by credit institutions before issuing covered bonds under a covered bonds programme in the interest of investor protection. Member States are empowered to confer the power to grant such permissions upon the relevant competent authorities and to lay down the requirements for the permission to be granted.

However, on the one hand, Article 19 of the proposal does not fall within the scope of Article 53 TFEU as it does not deal with the access to a profession (“*to take up and pursue activities as self-employed persons*”): the credit institution issuing the covered bonds would already have a licence to act as such and hence its general activity in the market does not depend on it getting permission under this article. Rather, the requirement for a permission is only an additional condition in a situation where bonds are issued under a programme.

On the other hand, even if Article 19 were to be considered as dealing with the access to a profession, it would be an element that is only accessory to the preponderant aim of the proposal, which is the harmonization of the regulatory treatment of covered bonds. According to the case law, the measure must be based on a single legal basis, namely that required by the main or predominant purpose or component.

Since the proposal is made with the express objective of harmonisation in respect of covered bonds within the internal market, its legal basis must be Article 114 TFEU.

VI - Conclusion and recommendation

In the light of the foregoing analysis, Article 53 TFEU, which allows the adoption of measures for the approximation of national provisions concerning the access to a profession, is not an appropriate legal basis for the proposal. Article 114 TFEU alone is thus a sufficient legal basis for the directive.

At its meeting of 18 March 2019 the Committee on Legal Affairs accordingly decided, by 15 votes to 0, with 0 abstentions⁸, to recommend that the Committee on Economic and Monetary Affairs could therefore agree to the deletion of Article 53 TFEU, as provisionally agreed with the the Council.

⁷ See the Opinion of the Legal Service, SJ-0199/18, point 17.

⁸ The following were present for the final vote: Pavel Svoboda (Chair), Jean-Marie Cavada, Kostas Chrysogonos, Sergio Gaetano Cofferati, Geoffroy Didier, Pascal Durand, Rosa Estaràs Ferragut, Jytte Guteland, Heidi Hautala, Sylvia-Yvonne Kaufmann, Virginie Rozière, Axel Voss, Tadeusz Zwiefka, Dominique Bilde (for Marie-Christine Boutonnet pursuant to Rule 200(2)), Josef Weidenholzer (for Evelyn Regner pursuant to Rule 200(2)).

Yours sincerely,

Pavel Svoboda