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Covered Bond Review
Banking and Credit Team
HM Treasury
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1 July 2011

Dear Sirs

Review of the UK's regulatory framework for covered bonds

This is the Financial Services Consumer Panel's response to the HM Treasury/Financial Services Authority consultation paper on the review of the UK's regulatory framework for covered bonds.

Overview

Our response is focused on the issues that have the greatest impact on retail investors, who have access to a wide range of UCITS and non-UCITS retail funds that are permitted to hold up to 25% of their assets in regulated covered bonds from a single issuer, many of which are available to by on-line on an execution-only basis. There will be other consumers possibly unaware that they have an indirect exposure to covered bonds perhaps through their pension investments. In the Panel's response to the original proposals for a UK recognised covered bonds regime we explained that from a retail investor perspective, the ultimate significant and concentrated exposure to covered bonds was the key issue. We called for measures to ensure high quality underlying assets and a robust regulatory framework and that position remains unchanged.

We are pleased to support many of the proposals in the Paper aimed at strengthening the regime, although we do have some concerns about single asset issues, largely around overcollateralisation requirements and the possible development of a two-tier market in terms of asset quality.

Our responses to specific questions within the Paper are set out below. We are not in a position to comment on the draft legislation or Sourcebook text.

Segregating asset types

Do you agree the UK regime should give issuers the option to formally designate their programmes as backed by a single type of asset, and that the draft legislation achieves this?

The proposals should provide greater clarity for the market and for investors and in principle we are supportive. We do however have some concerns.

First, as is noted in the Paper, designating a programme as “single asset” could cause difficulty where an issuer finds in times of stress, or other significant change, that it has insufficient assets of a particular type to top up an issue. The Paper goes on to say that the FSA’s registration process already includes an assessment of an issuer’s ability to continue to originate eligible assets, suggesting that the risk is mitigated by FSA requirements. Given the lessons learned from the financial crisis however, we would like to see the FSA and in due course the Financial Conduct Authority (FCA) taking a closer and particularly robust approach to anticipating and dealing with any potential ‘deficit’ in single asset programmes.

Second, we think it possible that the existence of mixed asset alongside single asset bonds might over time create a two tier market in terms of quality of assets, perhaps with the highest quality assets migrating to the single asset programmes. Ultimately if such a position met the demands of the market and, importantly, the regulatory regime accommodated the differing overcollateralisation and transparency requirements, the Panel would not wish to see any undue restriction on the UK market.

Finally, given the anticipated growth in the covered bonds market and the impact of this and the changes proposed in the paper, we would like reassurance that the FCA will have access to sufficient resources to regulate the covered bonds regime effectively.

Asset eligibility

Do you agree that securitisations should be excluded as eligible property in UK regulated covered bonds, and that the draft legislation achieves this?

Yes, we agree. The Paper correctly notes the important distinctions between covered bonds and securitisations. Including securitisations as eligible assets blurs those lines and could in our view weaken the strength of the covered bonds regime.

Do you agree that the list of assets eligible for inclusion in UK regulated covered bonds should not be expanded?

We agree. The inclusion of assets such as unsecured consumer loans could undermine the UK covered bonds market and, by definition, present a far greater risk to retail investors. Even with full disclosure such issues could be considered unrealistically ‘secure’ given the profile of the covered bonds market as a whole.

Fixed minimum overcollateralisation requirement

Do you agree the UK should introduce a fixed minimum level of overcollateralisation and an interest coverage requirement for regulated bonds, and that the draft legislation achieves this?

We support these proposals that would set a comparable ‘floor’ requirement with other Member States, provided that they did not lead to a general lowering of the individual overcollateralisation requirements imposed by the regulator.

At which level should the minimum overcollateralisation requirement be set?

The Panel is not in a position to comment on the level at which the minimum requirement should be set, but given that the Paper makes it clear that a minimum in the area of those shown in table 3.B would be “well below” the current levels of overcollateralisation in the UK, a higher figure would seem to be appropriate.

Asset pool monitor

Do you agree that the UK should introduce an independent Asset Pool Monitor for regulated covered bond programmes, with the powers and responsibilities described above, and that the draft legislation and Sourcebook changes achieve this?

We agree. The introduction of an Asset Pool Monitor as proposed would provide additional independent assurance for retail investors. We support the provision of guidance from the FSA on the Asset Pool Monitor’s Annual Report and the provision for bilateral discussions between the Monitor and the regulator on questions relating to individual issuers and asset types.

Investor reporting

Do you agree that the UK should introduce a mandatory loan-level disclosure requirement for regulated covered bonds, in line with the Bank of England requirements, and that the draft legislation and Sourcebook changes achieve this?

We strongly support the introduction of investor reporting, including loan-level data, as set out in the Paper. How helpful that will be to retail investors and investment advisers will depend to a large extent on the clarity and accessibility of the information. We would like the FSA/FCA to monitor the quality of disclosure and, if practicable, the extent to which this is considered useful by investors and advisers.

Integrated model

Do you agree that the UK should not introduce an ‘integrated model’ for regulated covered bonds?

We agree. The Special Purpose Vehicle model provides clarity around the segregation of assets to support covered bond issues. This could be brought into doubt if an integrated model was used.

Eligible issuers

Do you agree that the UK covered bond regime should be limited to issuance by firms registered in the UK?

Yes, we agree. The reasons for the original decision in 2008 remain essentially unchanged.

Timeline for implementation

Are you content with the proposed timeline for implementing changes to the regime by the end of 2012?

We support the implementation of changes by the end of 2012.

Yours faithfully

Kay Blair
Vice Chair
Financial Services Consumer Panel