

Financial Services Consumer Panel

AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

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Financial Stability and Risk
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Our ref: Consultations HMT

15 October 2007

Dear Ms Engledow

Proposals for a UK Recognised Covered Bonds Legislative Framework

This is the Financial Services Consumer Panel's response to recent proposals by HMT for a UK recognised covered bonds legislative framework.

Overview

The most significant aspect of these proposals for UCITS compliant covered bonds and retail investors is the likely increase in concentration risk, as we do not believe that the current proposals provide sufficient safeguards as to the quality of underlying assets. Consequently we have focused our response on this issue and the specific questions which relate to it.

It appears to the Panel that initially the proposals have been driven by the objective of enabling UK issuers to compete on a text book 'level playing field' in the EU. But in addition there seems to be a desire to 'second guess' where the market might develop in future and to extend the regulatory framework to cater for potential new developments, without sufficient regard to a number of pragmatic issues. For example, the proposed list of permissible locations of eligible properties includes jurisdictions where while on paper enforcement of judgement in the UK should be possible, but where common sense dictates that in practical terms the suggestion is naïve and unworkable due to politics, servicing costs of asset pools etc.

The unintended consequences of this unrealistic approach could be an adverse impact on the quality and integrity of the UK covered bonds market and the exposure of retail investors to a high concentration of risk in assets of lesser quality than they would expect when investing in a UCITS compliant covered bond.

Our specific comments and recommendations are set out below. In particular we urge HMT to:

- Limit eligible property to mortgages and public sector loans only

- Restrict asset location to EEA countries only
- Specify AAA rating as a mandatory recognition requirement.

Specific Questions

Q1: Do you agree in the first case, subject to the other requirements of the regime, that any credit institution with its registered office in the UK should be able to issue UK Recognised Covered Bonds?

Q2: Do you agree that the location of the registered office of the issuing credit institution should be broadened if enforcement will be deliverable?

We agree that any credit institution should be able to issue, subject to compliance with other requirements of the regime, UK recognised covered bonds provided they have their registered office in the UK. If consideration is to be given to applications from issuers with registered offices in another EEA States we would expect enforceability to be investigated from a practical, realistic viewpoint rather than on a solely legal or contractual basis. However, as the objective of the regime is to provide access to a level playing field for UK issuers we see no reason to extend it to other EEA states. We have already expressed our concern to the EU about the drive to increase sales of financial products across borders in the EU when consumer protection was lagging so far behind it, particularly when it comes to enforcement of rights and the lack of comprehensive EU wide alternative dispute resolution services.

Q4: Do you think anything further should be added to the proposed legislative regime to impose more detailed quality requirements on the market such as the minimum level of over collateralisation or the LTV limits for mortgages?

Q5: Do you agree with our general approach?

We support a principles-based approach, provided that it is robustly enforced, and the establishment of a flexible rather than prescriptive regime as regards the structure of the issues. We do feel, however, that an AAA rating of the bonds should be mandatory. We are not persuaded that without such a requirement, the proposed regime would provide the necessary certainty as to the high quality and low risk bonds that retail investors are entitled to expect from this market, particularly in view of the high concentrations permitted under the UCITS Directive. We do not have specific views on appropriate levels of over collateralisation or loan to value limits for mortgages, although we believe that these could be useful tools for ensuring the quality of the asset pool.

Q11: Is it appropriate to widen the list of eligible property beyond the BCD list?

Q12: Are you satisfied that the definition of eligible property in Regulation 3 has the correct balance between flexibility in eligible assets and their suitable quality?

Q13: Is there a better way to define the eligible property so as to provide flexibility while ensuring the quality of the assets in the pool?

Q14: Do you think it is appropriate to define the location of the eligible property backing the pool?

The Panel's view is that eligible assets should be mortgages and public sector loans only. We do not think it appropriate for other assets to be included as, first, it would not be appropriate given the primary purpose of the market is to facilitate funding for long term fixed rate mortgages and, second, the quality of the assets would not in our view meet the standards that should prevail in the UK covered bond market. In particular the proposal to include other assets as listed in paragraph 2.39 of the Paper could impact on the reputation and credibility of the market. At the very least the inclusion of most if not all of the other listed assets could impact on the reputation and credibility of the Market to potential investors. It is important that the structure of the Market and the regulatory regime that underpins it inspire confidence in potential investors.

Q15: Are you happy with our proposed definition of the suitable location of such assets?

No. We are strongly opposed to the proposed definition as we do not think that sufficient account has been taken of the reality of enforcement processes. We recommend that location should be restricted to EEA States. Given that the paper acknowledges that it is vital to keep in mind that the choice of permitted location must be informed by the need for security and availability of assets held outside the UK, we are surprised by the inclusion of a number of locations where the actual enforcement of judgement in the UK would be time consuming, risky and expensive – if not impossible in real terms. We also note that no account has been taken of servicing costs for asset pools in less developed, more remote locations.

Q19: Do you have any comments on the ring-fencing in the Regulations and the requirements placed on the owner, issuer and liquidator?

We have no objection to the proposals.

Q21: Do you agree that the service providers can be paid as an expense of the winding up?

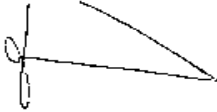
Yes. This is entirely appropriate and without this assurance service providers might be reluctant to undertake business in this market at all.

Q23: Do you think we should put the set-off position beyond doubt?

In the absence of case law we are not sure that the set-off position can be put beyond all doubt, but we agree that it is important for HMT to take steps to establish

the position to a reasonable degree of certainty at this stage.

Yours sincerely

A handwritten signature in black ink, consisting of a vertical line on the left, a horizontal line extending to the right, and a diagonal line crossing the horizontal one from the top right towards the middle.

John Howard
Chairman
Financial Services Consumer Panel