



The voice of banking
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Joint association response to the Proposals for a UK Recognised Covered Bonds legislative framework.

Introduction

We are pleased to have the opportunity to respond to the joint FSA and HM Treasury consultation on the *Proposals for a UK Recognised Covered Bonds legislative framework* on behalf of our members, who have contributed very fully to our response. There has been extensive dialogue on the proposed regime between the industry and both the FSA and the HMT of which we are particularly appreciative.

The BBA is the leading UK banking and financial services trade association and acts on behalf of its members on domestic and international issues. Our 225 banking members are from 60 different countries and collectively provide the full range of banking and financial services. They operate some 130 million accounts, contribute £50bn to the economy and together make up the world's largest international banking centre.

LIBA is the principal trade association in the United Kingdom for firms active in the investment banking and securities industry. The Association represents the interests of its members on all aspects of their business and promotes their interests both domestically and internationally.

The International Capital Market Association (ICMA) is the self-regulatory organisation and trade association representing constituents and practitioners in the international capital market worldwide. ICMA represents a broad range of capital market interests: its 400 members are located in 48 countries and include global investment banks, regional banks, asset managers, exchanges, central banks, law firms and other professional advisers. ICMA seeks, both at the national and supranational level, to ensure that financial regulation promotes the efficiency and cost effectiveness of the capital market.

The Council of Mortgage Lenders is the trade association for the mortgage lending industry. Its 163 members are banks, building societies and other mortgage lenders as well as advisors and account for around 98% of UK residential mortgage lending. It seeks to foster a favourable operating environment in the UK housing and mortgage markets and is the representative

voice for the residential mortgage lending industry and the central provider of economic, statistical, legal, research and other market information.

We have responded to the questions in the order that they have been asked. Our answers reflect the consensus view but there are still areas in which we think further work needs to be undertaken and we look forward to working on them with the authorities in the near future.

Key messages

Importance of the Covered bond market as a financing tool

The covered bonds market is a key source of cost-effective funding for our members so they are pleased that the authorities are putting in place a regime that underpins UCITS 22(4) compliance and support the flexible, principles based way in which it is being implemented. It is desirable both from an industry and public policy perspective that efficient sources of funding for mortgages are available.

Robustness of market

It is important that the UK covered bond market as perceived is just as robust as other covered bond markets in Europe, some of which have more prescriptive credit quality or over-collateralisation requirements. We do not believe such tests are appropriate. But it is important that capability to pay is interpreted by the FSA as applying only to the very highest quality of bonds presenting low risk to investors whose covered bonds are comparable with government debt. We expect that the FSA's implementation of the UK recognised covered bonds regulations will ensure that this is the case, but we have, in addition, suggested explicit reiteration of its general duties under section 2 of FSMA in relation to covered bonds in the paragraph 7 of the statutory instrument.

EEA branches

We welcome HM Treasury's desire for open and transparent markets and therefore the discussion in the consultation as to the possibility of allowing branches of other Member State banks to participate in the UK covered bond market. We recognise that this raises both enforcement and supervisory questions but do not believe that these would be insurmountable if the regulations give the FSA sufficient power over the programme to fulfil its public supervision responsibilities. We think that this can be achieved by requiring that the segregated model is used, the SPV has its registered office and centre of main interest in the UK and that the assets are predominantly located in the UK.

Location of assets

We believe insolvency is the wrong filter for deciding upon the location of assets. We think that the right filter would be the ability to foreclose. However, we do not believe that there is a principle that would encapsulate this ability that would be effective, because of different approaches across jurisdictions. As a

result we have proposed a list of countries, where we feel confident that foreclosure would work and that would be acceptable to investors.

Material changes to covered bond programmes.

We support the range of powers that HM Treasury is proposing to give the FSA under the draft Regulations. However, we recommend that the FSA also be given the power to veto material changes to a covered bond structure that would take it out of compliance with the Regulations. We believe that this is necessary to protect the robustness of the regime, ensuring that all bond holders can be confident that once they have bought into a Recognised Covered Bond it will always be Directive compliant.

Insolvency issues

We are aware that the proposed Regulations raise a number of issues in relation to how the regime will work where there is insolvency. We address some of the issues in this paper, in order to clarify the provisions relating to the segregated model. In addition we fully support the response submitted by the City of London Law Society.

Legal issues

Other significant legal points are addressed in Annex 1a prepared by Allen & Overy, Clifford Chance and Linklaters. These are:

- Seller of the assets other than the issuer
- Issuer/owner distinction
- Insolvency definition
- Register of covered bond programmes

This annex also provides commentary on other more technical issues.

Responsibilities of the owner post insolvency

As currently drafted Regulation 16 requires that the owner must make arrangements for the maintenance and administration of the pools so that to ensure that the asset pool is capable of covering the claims of bondholders and that there will be timely payment. FSA sourcebook section 3.7 requires the owner to attest to meeting the requirements in Regulation 16, pursuant to Regulation 17. We are unsure that it will be possible for the owner to fulfil these obligations, only the issuer can do so.

Questions

- 1 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?**

Yes.

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

Although we recognise HMT's desire to enable as many different institutions as possible to access the covered bond market our prime concern is to ensure that covered bonds remain an effective liquidity management tool for our issuing members, rather than as a means for investors to gain exposure to particular credit structures. In these circumstances the perceived robustness of the UK regime is of paramount importance - we do not wish the nascent UK covered bond market to be associated with 'weaker' issuing criteria. Rather covered bonds should be associated by investors with homogeneity, simplicity, high quality and low volatility and be easy for them to assess. The achievement of these characteristics will lead to increased funding capacity, deeper market penetration and lower funding costs for UK issuers; all of which will ultimately benefit UK consumers.

It is our view that the prime focus of the UK covered bond market is to provide the most cost effective funding for our members in order that they can continue to provide access to a range of mortgage funding options for British citizens. Widening the range of credit institutions able to access this market risks harming the reputation of the increasingly important UK covered bonds market which may result in higher funding costs for issuers.

However we believe that there is a case for permitting the UK branch of an EEA registered bank to issue UK covered bonds. We recognise that there are supervisory issues if both the branch and SPV are outside the UK which could cause the FSA enforcement difficulties. Therefore we propose that the SPV should be registered in the UK with its COMI there and that it is financing assets that are in the UK.

To summarise we propose that the RCB framework should be limited to:

- i) UK authorised banks financing assets globally

as well as:

- ii) UK branches of EEA registered banks financing UK eligible property through the segregated approach, if the assets have been transferred to a separate owner that has its registered office and its centre of main interest (COMI) in the UK and accordingly where UK insolvency law would apply to that separate owner.

3 What are your views on the possible obstacles to the integrity of the enforcement regime?

We recognise that our proposal that UK branches of EEA registered banks be permitted to access the proposed UK recognised covered bonds regime presents some enforcement issues. But we believe that these can be overcome as the proposed regulations confer powers on the FSA to give directions to the

issuer and require higher levels of information on application if necessary to aid the decision.

Furthermore the FSA has powers to ask for more information at any time. We envisage it might want to ask for more detailed information at the application stage from EEA banks issuing through a UK branch to address the more limited supervisory relationship.

In addition the FSA has wide powers to direct in relation to UK permanent branches and could use skilled persons' reports after recognition to gather further information. We also believe that the greater levels of supervisory cooperation we see between regulators in Europe, which is welcome, provides a more informal route to assist with the oversight of UK branches of EEA registered bank issuing covered bonds.

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

We strongly support HMT's principles based framework and think that the establishment of asset parameters and the inclusion of the capability criterion strike an appropriate balance between robustness and flexibility, thus allowing for future innovation.

We note that as regards sub para d of BCD annexe VI, para 68 includes LTV criterion.

However we do think that it is important to convey the message to observers of the emerging UK covered bond market that it is intended to be used only by the very highest quality of issuers. To this end it would be helpful to expressly incorporate the FSA's general duties under section 2 of the FSMA into the Regulations, but with appropriate modifications such as:

- the regulatory objectives are (i) maintaining market confidence in UK covered bonds and (ii) the protection of covered bondholders (i.e. delete references to financial crime and public awareness);
- references to "authorised persons" means a person to whom these Regulations apply;
- references to "regulated activities" means the issuance of covered bonds under these Regulations.
- FSMA sections 2(3) (f) and (g) are not necessary

5 Do you agree with our general approach?

We strongly support the proposed principles based approach. We think that it provides maximum flexibility to address market innovation while maintaining the robustness of the covered bonds regime. We think that it is appropriate that senior management should have primary responsibility for ensuring that

recognised covered bonds meet the spirit rather than just the form of the regulatory requirements.

We also think that it is appropriate that the regulations should focus on the assets and in particular their ring-fencing, and that the structure of the existing UK covered bonds should be recognised. We recognise that HM Treasury wishes to promote maximum flexibility and choice by also introducing the integrated model. However, as industry Members do not intend to make use of the integrated model we offer no thoughts on the policy issues raised by this approach.

As noted above in Q4, we support HM Treasury's decision not to include prescriptive requirements for asset quality.

6 Do you agree with the functions we propose to give the FSA and the recognition process for issuers and their programmes?

We agree that special public supervision is a key aspect of ensuring the robustness of a UK covered bond regime. So we support HM Treasury's proposed approach to give the FSA the power to recognise both the issuer and the individual bonds (and to maintain a register in this respect); that they should be recorded on an register; to notify the Commission of UK covered bond programmes, issues and the status of guarantee; of ongoing supervision; to veto changes of ownership, to enforce the regime, and to remove issuers from the register.

In addition we think that the FSA should also be given the power to prevent a change to the structure of a covered bond programme if there is a risk that it would subsequently fail to meet the requirements of the regulations. We think that it is highly unlikely that any issuer would seek to make a significant change to their structure. However, since they are governed predominantly by contract we think it is important for the robustness of the regime that the FSA have the power to veto such changes.

We remain concerned about the power to fine the owner in the event of a 'minor' regime breach when the issuer is insolvent. In our view this power runs counter to the objective of protecting bondholders, since in this circumstance any fine would have to be paid out of the proceeds of the cover pool.

7 Do you agree with the proposed time limits for the recognition process?

We think that the six month period proposed is too long because of the commercial necessities of bringing a deal to market. Firms will take account of market conditions in determining when to issue and these can change significantly over a six-month period. Although we think that six months is too long, we do not propose that there should be a change in the regulations and regard it as a backstop. However in normal circumstances, for a UK issuer, we think that the FSA should be able to respond in a much shorter time period and that it should commit to a service standard as it does for waiver requests. We

think that a period of three months from the time of receipt of the application is appropriate. If the FSA requests further information during the three month period, then this should be provided within one month. In practice we would envisage that members will approach the FSA prior to submission of the final application to ensure that issues are appropriately addressed. This will be necessary because some information, for example precise size and composition of the pool will not be established until the very end of the process.

For a non-UK issuer, we recognise that the FSA may wish to undertake additional reviews because of the more limited supervisory relationship that they will have with a branch as compared to a subsidiary, or UK credit institution. As a result we think that the Regulations would act as a backstop to this process.

We would be interested to understand how the approach to the initial applications of existing structures will be handled and look forward to discussing this with you shortly.

8 Do you think there should be different time limits for recognition of the covered bonds where the issuer has already been recognised?

No, but we would similarly expect to see a service standard from the FSA, which should be no more than three months.

9 Do you agree with the rationale for the enforcement provisions and the enforcement powers the FSA will have for this regime?

We agree that robust enforcement powers are necessary to ensure that the UK covered bond regime has integrity. We agree that in principle the FSA should be given the power to direct; prevent a change of ownership if there is a risk that the new owner will not meet the requirements of the regulations; remove the issuer from the register; obtain court orders; and to fine the issuer.

We agree that it is appropriate for the FSA to step in and make directions if there is a material risk to bondholders, e.g. to transfer the asset pool. However, given the breadth of the power we think that it is important that the sourcebook clearly outlines how the FSA plan to use it, otherwise investors might be concerned by possible intervention in transactions that may change the terms on which they have bought into the programme. We think it would be helpful if the sourcebook were to contain examples of breaches that would cause it to intervene.

As regards the ability to fine, as noted above, we do not believe that it is appropriate that the FSA should fine the owner once the issuer is insolvent.

10 Are the types of assets permitted in the asset pool defined appropriately in Regulation 2?

As the authorities are aware, assets destined for inclusion in a covered bond programme are actually acquired prior to the issuance of the bonds themselves.

We would prefer that this actuality is recognised in the regulations, but accept that a purposive interpretation may be appropriate.

As currently drafted the pool is partially determined by the obligation on the issuer to record the assets in the pool. However, the resulting list is not determinative of the contents of the pool in the regulations. To avoid the circularity this creates, we suggest that assets on the list are deemed to be those in the pool. We propose suggested drafting below:

'16(2) Where an asset is recorded as being held in the asset pool that asset shall be irrebuttably presumed to belong to the asset pool for the purposes of these regulations.'

We believe that the definition of "asset pool" does not cover the additional assets required to be transferred to the asset pool from time to time in order to ensure there is an appropriate level of over-collateralisation in the pool for rating agency purposes. In our view this point is not covered in Regulation 13 either. Neither does it address the benefits of hedging agreements and insurance in relation to the bonds or asset pool. Accordingly, we have suggested some additional wording in paragraph 2 of the attached mark-up of the Regulations.

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

Yes. We welcome the inclusion of secured loans to a registered social landlord and PPP/PFI loans which we believe are equivalent to assets in covered bond programmes in other jurisdictions.

12 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?

On reflection, we think a more restrictive list is needed because of the goals of robustness, transparency, and simplicity. So we recommend that subsection (a) of paragraph 3 of the Regulations should be amended. We recognise that reducing the scope of this list will, to some extent, reduce the flexibility of the covered bond framework. However, the goals of robustness, transparency, simplicity and (by extension) liquidity must be paramount. However, we do not wish to imply that covered bonds backed by other CRD assets beyond those specified below are of a reduced quality.

We believe that the restriction of the list to the assets referred to below (i.e. replace item (a) and include the existing items from the draft Regulations) will allow a sufficient degree of flexibility, while delivering the greatest possible benefits to issuers and, by extension, UK consumers.

(a) exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the EU;

(b) exposures to or guaranteed by non-EU central governments, non-EU central banks, multilateral development banks, international organisations that qualify for the credit quality step 1 as set out in ~~this~~ Annex VI of the Banking Consolidation Directive, ~~and exposures to or guaranteed by non-EU public sector entities, non-EU regional governments and non-EU local authorities that are risk-weighted as exposures to institutions or central governments and central banks according to points 8, 9, 14 or 15 respectively and that qualify for the credit quality step 1 as set out in this Annex, and exposures in the sense of this point that qualify as a minimum for the credit quality step 2 as set out in this Annex, provided that they do not exceed 20 % of the nominal amount of outstanding covered bonds of issuing institutions;~~

(c) exposures to institutions that qualify for the credit quality step 1 as set out in ~~this~~ Annex VI of the Banking Consolidation Directive. The total exposure of this kind shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds shall not be ~~comprised~~ included by the 15 % limit. ~~Exposures to institutions in the EU with a maturity not exceeding 100 days shall not be comprised by the step 1 requirement but those institutions must as a minimum qualify for credit quality step 2 as set out in this Annex;~~

(d) loans secured by residential real estate ~~or shares in Finnish residential housing companies as referred to in point 46~~ up to the lesser of the principal amount of the liens that are combined with any prior liens and 80 % of the value of the pledged properties or by ~~senior units issued by French Fonds Communs de Créances or by~~ exposures to equivalent securitisation entities governed by the laws of a Member State securitising residential real estate exposures provided that at least 90 % of the assets of such ~~Fonds Communs de Créances or of equivalent~~ securitisation entities governed by the laws of a Member State are composed of mortgages originated by the issuer or an affiliate of the issuer that are combined with any prior liens up to the lesser of the principal amounts due under the exposures ~~units~~, the principal amounts of the liens, and 80 % of the value of the pledged properties and the exposures ~~units~~ qualify for the most favourable rating within credit quality step 1 as set out in ~~this~~ Annex VI of the Banking Consolidation Directive ~~where such units do not exceed 20 % of the nominal amount of the outstanding issue~~. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be ~~comprised~~ included in calculating the 90 % limit;

(e) loans secured by commercial real estate or ~~shares in Finnish housing companies as referred to in point 52~~ up to the lesser of the principal amount of the liens that are combined with any prior liens and 60 % of the value of the pledged properties or by ~~senior units issued by French Fonds Communs de Créances or by~~ equivalent exposures to securitisation entities governed by the laws of a Member State securitising commercial real estate exposures provided that, at least, 90 % of the assets of such ~~Fonds Communs de Créances or of equivalent~~ securitisation entities governed by the laws of a Member State are composed of mortgages originated by the issuer or an affiliate of the issuer that are combined with any prior liens up to the lesser of the principal amounts due

under the units, the principal amounts of the liens, and 60 % of the value of the pledged properties and the ~~exposures~~^{units} qualify for the most favourable rating within credit quality step 1 as set out in ~~this~~ Annex VI of the Banking Consolidation Directive ~~where such units do not exceed 20 % of the nominal amount of the outstanding issue~~. The competent authorities may recognise loans secured by commercial real estate as eligible where the Loan to Value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in Annex VIII of the Banking Consolidation Directive. ~~The bondholders' claim must take priority over all other claims on the collateral~~. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be ~~comprised~~ included in calculating the 90 % limit ~~or~~

~~(f) loans secured by ships where only liens that are combined with any prior liens within 60 % of the value of the pledged ship.~~

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

We believe it is best to define the list of eligible property as described in our answer to question 12 which is a more limited list than that included in the CRD.

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

Yes. However we do not think that Insolvency Act/UNCITRAL status and ability to access security is the right filter to apply to determine asset location. We think that the ability to foreclose is more pertinent, but we do not think that it is possible to encapsulate this in a criterion because of the different approaches across jurisdictions. Therefore we recommend that a list of eligible jurisdictions should be provided instead. In proposing the list in our answer to question 15 we have also taken into account the practices and sentiments of the covered bond market generally. The importance of the latter cannot be overestimated, as it is the attitude of this market towards the perceived robustness of the UK legislative regime that will in large part determine whether the legislation has succeeded or failed. The list of jurisdictions set out in response to question 15 below does not seek to form a judgement as to the credit quality of assets located in various jurisdictions; however it does seek to conform the UK legislative regime to market expectations.

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

We would suggest limiting the suitable locations to the following list of countries:

- EEA countries

- Switzerland
- Japan
- United States
- Canada
- Australia
- New Zealand
- Channel Islands
- Isle of Man

16 Do you agree that the Regulations should adopt the ‘copy out’ approach with regard to capability to pay? Or do you think that for reasons of legal certainty the Treasury should include examples of different ways in which the capability test may be met?

Yes. We agree that a copy out approach should be adopted. As noted there are a variety of different ways in which the capability test may be met – developments in the market may render some more or less relevant and it is unlikely that it is possible to identify now all potential methods of confirming capability. Therefore we think it would be inappropriate to prescribe methodologies in the regulations.

17 Do you think that there are other methods for assessing capability?

The consultation document helpfully lists a number of ways in which capability could be assessed. Others include ECAI models that stress test portfolio parameters such as probability of default, exposures at default, loss given default and maturity using a weighted averaging methodology. These highlight the interconnectedness of these parameters. So a too simplistic an approach, specified in the regulations, could unduly constrain assessment techniques and even give rise to a false sense of security.

18 Which do you think are the most suitable methods for assessing capability?

At present we believe that capability is assessed by senior management of the issuer using a variety of techniques, often guided by complex internal and ECAI models. The suitability of approaches may change over time as market practices evolve and we would not want one approach specified for this reason. However, we discuss the sort of information necessary to make that determination in question 25, regarding the application process.

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

We support the flexibility provided for by the draft regulations although believe that the SPV approach will remain the dominant one after their implementation. Our members have not indicated to us that they plan to employ the integrated

approach but are comfortable that the SPV approach accommodates existing structures, which is a key priority. The City of London Law Society paper, which we support, explains industry concerns about insolvency issues relating to both the segregated and on balance sheet approaches.

20 Do you think that the protected period in Regulation 25(10) is the correct length?

Yes, a 12 month protected period is appropriate in the first instance but we agree that the ability to apply to the FSA to extend this period is also necessary.

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

We have some comments about how this might work. In addition we have a significant issue regarding the priority of service providers in a pre insolvency situation. These are discussed further below.

Winding up

We think draft Regulation 28 goes some way to addressing our concerns by proposing that if the owner is in the process of being wound up, the claims of the relevant service providers will be paid as an expense of the winding up. However, we note that:

- a) It is not clear where these expenses would sit in Schedule 3 of the Insolvency Act;
- (b) The drafting of the Regulations would seem to override the discretion of the liquidator to incur such service costs as a cost of the winding up, because there is an explicit statutory requirement for them to be paid *pari-passu* with the covered bondholders, and in the case of any shortfall, for the relevant claims to abate in equal proportions – so we are not sure that the Regulations achieve the intended purpose;
- (c) A liquidator has discretion as to whether it will pay such service costs. This is likely to be unacceptable to the relevant service providers and to the rating agencies.
- (d) A further outstanding issue is how pre-liquidation expenses will be dealt with post-liquidation: will these be given priority, whether as an expense of the liquidation or specifically pursuant to the terms of the Regulations? This will be a key concern for service providers as well.

From a rating agency perspective, it is also important that the claims of some service providers are *subordinated* to the claims of the covered bondholders – e.g. termination payments due to a hedge counterparty when it has defaulted, or certain unquantifiable indemnities due to other service providers and subordinated amounts due to the asset transferor and the issuer under its loan to the separate owner (from which the separate owner acquires the assets).

Enforcement of security

In the in old draft Regulation 27(2) it is further proposed that where a fixed or floating charge is being enforced over the assets in the asset pool, the claims of covered bondholders and relevant service providers will rank ahead of the claims of chargee and those claims will rank pari-passu and abate proportionately if there is a shortfall. There are two issues for consideration here.

- (1) It should be noted that the claims of covered bondholders and service providers/hedge counterparties will be (and are in the existing UK covered bond deals) secured by fixed and floating charges over the asset pool established in relation to a particular covered bond programme. Hence the wording in the regulations has the effect of saying covered bondholders and service providers/hedge counterparties will rank after the persons referred to in regulation 28(1) (i.e. the covered bondholders, service providers and hedge counterparties). This does not make sense. However, we have proposed an amendment to Regulation 27(2) to make it clear that the claims of the covered bondholders and the service providers/hedge counterparties have priority in enforcement – i.e. the statutory language reinforces the contractual rights conferred by the security documents.
- (2) If the purpose of Regulation 27(2) is to give priority to covered bondholders and service providers/hedge counterparties over the fixed and floating charges created by the issuer over the cover pool in favour of third parties, then we have suggested some additional wording to this Regulation to cover this point.

The concern of rating agencies to subordinate the claims of certain service providers and certain claims of the hedge counterparties as noted above, will apply also apply in the context of enforcement of security.

Pre-enforcement/winding up

As a matter of commercial necessity, service providers require priority in covered bond structures. Their claims need to be paid to ensure that bondholders receive payment. As a result existing UK and certain other European covered bond transactions are structured to give these service providers priority.

It is our view that pre insolvency a purposive interpretation of the Directive wording will be required – i.e. the point is that covered bondholders, service providers and hedge counterparties in relation to the covered bonds must rank ahead of other creditors of the issuer. If a purposive interpretation is not applied this will present problems Since there are structures in other jurisdictions where the service providers receive priority, we think it is appropriate to interpret 'priority' in the context of investors to the scheme in relation to the claim on the underlying assets. If this issue is not satisfactorily addressed, there will be significant implications for the development of the UK covered bond market.

As a result we think that there is still an issue that needs to be addressed in the regulations, preferably by the deletion of Regulations 27(2) and 28 (2).

Two further points on this issue:

- (a) In addition the current proposals set out in Regulations 27 and 28 would also require the re-documentation of all existing UK structures and the consent of bondholders; and
- (b) The term "service providers" does not really capture the role of a hedge counterparty, and they should be specifically referred to in the Regulations
- (c) As noted above, the rating agencies will be concerned to subordinate the claims of certain service providers and certain claims of the hedge counterparties.

We understand that in a pre insolvency situation at least one rating agency is concerned that the terms of Regulations 27(2) and 28(2) would prevent a liquidity facility provider/credit provider stepping in to provide temporary cash to a stricken deal as they would want to rank ahead of the other creditors. We understand that this is contemplated in the German covered bond regime.

22 Do you agree with our analysis of the set-off position?

Yes but we think legislation is only required to formalise the existing common law position. However as there is no direct case law on this point, issuers have to date taken a very conservative approach, and have agreed to hold substantial additional over-collateralisation to cover this risk.

23 Do you think that we should put the set-off position beyond doubt?

Yes we would like to see the existing common law position formalised in the regulations.

As noted above the position as regards set-off is relatively clear as a matter of law - once the borrower has been notified of the transfer of his mortgage to the SPV, the right to set off any deposit made with the lender against the amount due on the mortgage ceases. For the integrated model, however, there is no transfer of assets, and it is not clear that the common law set-off arises. If this continues to be the case, this will provide a significant disincentive for issuers to use the on balance sheet model. Consequently, we suggest a provision which ensures equality between the two structures which is neutral as regards them.

A provision to this effect would be:-

- (1) Where a borrower is notified by a lender that his mortgage has been transferred into a covered bond asset pool, he shall thenceforward lose the right to set off.

- (2) Subsection (1) shall apply regardless of whether the asset pool is held within an SPV or directly by the bond issuer.
- (3) For the purposes of this section, the right to set off which is lost shall be the same right as the right which is lost under the general law when a debtor is notified of an assignment; that is, the right to set off any deposit held by the lender or other similar claim against the amount due under the mortgage transferred. The right is not, however, lost in respect of any amount actually due and payable by the lender at the time of the assignment.

24 Do you agree with having a separate sourcebook? If not, please describe what you think should be done differently and explain why, including an assessment of costs and benefits.

Yes. Given the specialised nature of the regime we think that it will be more helpful for users if all the relevant material is in one place. So we think that where the covered bonds sourcebook draws on other parts of the regulatory regime, (e.g. enforcement) a short summary of the FSA's approach and more precise cross references should be provided.

25 Do you agree with the proposed approach of an issuer declaration at recognition? If not, please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

We strongly support the approach being taken with regard to senior management responsibilities. However we do have comments on the detail of the application process and the form itself.

It is our understanding that the FSA will only require the programme to be recognised and will not expect a review to be conducted on the issuance of each new bond from that programme. However, we think that it will be helpful for the individual bond references (ISIN numbers) to be recorded on the FSA website for the benefit of investors. Thus we think that it would also be helpful to include a notification process for the issuance of the bonds. This would only need to include the following information – issuer, bond programme, bond ISIN, maturity, currency, amount and hard or soft bullet.

As regards the application itself we would make the following comments:

- 3 We recommend that this question is omitted or amended. The permissions regime does not include a 'credit institution' regulated activity.
- 5 The strategy for issuing covered bonds will be part of the wider strategy of the firm as regards its funding. As such we think that this question would be more appropriately focussed around the process/controls over

the issuance of bonds within the firm's business strategy. We suggest *'What is the internal governance process for issuing covered bonds within the firm's business strategy?'*

7 In addition to the parties listed we think contact details for the following should also be requested:

- Corporate service provider
- Hedge providers
- Account bank
- Lawyers
- Auditor of the LLP
- Pool auditor

We think that these parties are also relevant to the FSA fulfilling its obligation to undertake public supervision should an insolvency situation arise.

8 We think the FSA should expect to see the following information in respect of the asset pool:

- Asset type – mortgages or other
- borrowing base requirements
- Whether assets were bought or originated (and if bought, from where they were acquired)
- BCD or broader UCITS compliance

9 We think that the FSA should expect to receive the following information as regards the capability of the bonds to repay:

- Over-collateralisation test
- Amortisation test
- Minimum margin
- Cashflow analysis
- Details of any ratings triggers

10 In the case of the segregated model the cover pool will already be separately ring-fenced outside the issuer. As such we think that this question would be better focussed on the mechanisms that ensure that the bonds are repaid in a timely manner. We think that there are two aspects that the FSA should address – mechanisms in place to address the risk of the insolvency of the issuer and as regards the pool, what would happen if the amortisation test failed. To address the former we think it would be appropriate to ask about the procedure for appointing a replacement servicer, cash manager/paying agent.

26 Do you agree with the proposed approach of a professional adviser declaration at recognition? If not, please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

As currently drafted, third parties will not be able to deliver the level of assurance requested by the FSA. Lawyers will not be able to opine to the statements of fact regarding the programme meeting all the requirements of the regulations, for example as to whether the bonds are capable of repaying the bondholders. So we think that it will be necessary to develop a checklist approach for the lawyers to highlight where in the documentation the various aspects of the requirements are addressed as follows:

- List the documentation prepared for the Covered Bond programme.
- Identify the provisions relating to the requirements set out in Regulation 13(2)
- Identify the provisions relating to the requirements set out in Regulation 16(a).
- Identify the provisions relating to the types of assets that can go into the asset pool.
- Identify the provisions relating to the location of the assets.
- Where the issuer is not the owner, identify the provisions relating to effect of (i) the insolvency of the issuer and [(ii) the insolvency of the owner.
- Identify the provisions which relate to the convening of meetings of investors in recognised covered bonds.

We anticipate that industry, working with the legal community, will develop standard form opinions, which would be addressed to the issuer's senior management (not the FSA) at the time the programme is established. These would also be made available to the FSA.

Similarly we anticipate that accountants would not be able to provide any opinion in relation to the "capability" of the asset pool in future periods. Nor would they be able to opine on management's processes for assessing and monitoring capability without detailed guidance from the FSA on what might constitute appropriate and adequate processes.

Accountants might undertake certain agreed upon procedures and report to the directors of the Issuer or Owner (rather than address it to the FSA) who might then disclose the report to the FSA. The report might cover, for example:

- Reperforming over collateralisation and other specified tests to determine whether the cover pool complies with certain limits
- Checking that the data used for these tests agreed to the Issuer's accounting records and supporting documents

This would build upon existing practice in the UK covered bond market where, as part of their due diligence, the Issuer and lead managers for the issue appoint accountants to perform agreed upon procedures in relation to assets in the cover pool. Accountants, in their role as asset monitor, also check that certain tests such as the level of over-collateralisation, have been correctly computed and are within pre defined limits.

The tests and acceptable limits are defined in the transaction documents, and typically reflect requirements of the rating agencies and should we believe also provide the FSA with sufficient comfort too.

See further the mark-up of Annex D.

27 Do you agree with the proposed approach to the Register? If not please describe what you think should be done differently and explain why, including an assessment of costs and benefits.

We agree with the proposal for the FSA to publish the register on its website. Investors amongst our Members have indicated that this will be a very helpful source of information. As noted above, we also think that it would be helpful to record the ISIN numbers of the bonds issued by the programme.

28 Do you agree with the proposed approach to notifications? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

We agree with the FSA's plans to notify the Commission as soon as possible and with the proposed approach to the status of guarantees.

29 Do you agree with the proposed approach of an annual issuer declaration? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

Yes we think this is a reasonable requirement.

30 Do you agree with the proposed approach of an annual professional adviser declaration? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

No, although we recognise FSA's objective in requesting third party declarations, as currently drafted the advisors have indicated that (as with the initial declaration) the scope is too broad for them to be able to opine. In addition there are issues for the advisors in terms of their liability in preparing the declarations for you direct which would add significantly to the cost of provision. In any event the advisors have indicated that to prepare an opinion along the lines of a 'Reg AB' report and an update of the legal opinions would

cost in the region of £150k per year per programme. We believe that it would be possible to give comfort on the issues addressed in a less burdensome manner by requiring senior management to ensure that the accountants have performed the requisite tests and for them to attest to the fact that it has evidence in its records to support this statement. In addition we have also proposed in question 6 that the FSA should be given the power to veto material changes that would take the covered bond programme outside the requirements of the regulations. We believe that these two provisions would give an equivalent level of confidence.

Of course the FSA has the power to ask the Issuer for any information it wishes at any time.

31 Do you agree with the proposed approach to reporting? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

Yes we do not believe routine reporting is required and prefer the FSA's proposal that reporting should be exception based and event driven.

However we are unsure of how an SPV could ensure that the issuer submits the requisite reports and have therefore suggested an amendment to 3.7.1 D. in addition we have some concerns about 3.7.3 D regarding the ability of the SPV's members/directors to provide the assurances required without indemnification out of the assets of the LLP. We would like to talk about this with you further.

32 Do you agree with the proposed approach not to set out in detail guidance on 'capability'? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

Yes we agree that detailed guidance on capability would not be helpful. Senior management of the issuer should determine how they believe capability is demonstrated and different issuers are likely to take different approaches to this.

33 Is the purpose of requiring there to be a bondholder representative function clear? If not please describe what further explanation is necessary.

Yes - we assume you mean a "bondholder trustee".

34 Do you agree with the proposed approach to *skilled persons' reports*? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.

As a concept we support the use of skilled persons' reports. But we are currently uncertain as to how and when you are proposing to use this supervisory tool.

- 35 Do you agree with the proposal to recover the costs of the Regime through a combination of recognition an ongoing fees payable by solvent issuers rather than owners? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.**

We agree that users of the regime should pay for it through upfront and ongoing fees, but are unsure how the actual sums have been determined and hope to receive more information on this is due course.

- 36 Do you agree with the proposal that any financial penalties received in one financial year should be distributed to issuers as a deduction from their ongoing fees in the following year? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.**

Yes, but we do not agree that the FSA should have the power to fine the separate owner in the event of the issuer's insolvency, as this would be to the detriment of bondholders.

- 37 Do you agree with the proposal to charge an administrative fee of £250 for failure to submit reports on time? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.**

On the basis that the annual report would only be provided by the issuer we have no problem with this proposal.

- 38 Do you agree with the proposed approach to directions? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.**

Yes - we are pleased to note the statement in the Consultation Paper that the FSA only anticipates using its direction making powers in exceptional circumstances. However to ensure that investors understand the likely and limited circumstances in which such powers could be used a summary of the enforcement powers along with examples would be helpful in the specialist sourcebook itself, which we see as being a standalone document.

- 39 Do you agree with the proposed approach on penalties? If not please describe what you think should be done differently and explain why, including an assessment of the costs and benefits.**

Yes, but as we note above, penalties should not be imposed on the owner of the assets.

40 While Pillar 2 does not form part of the Regulations or the Regime it is an important consideration for many covered bond issuers and investors. Ahead of the work planned on Pillar 2 and the encumbrance of assets do you have any comments?

We eagerly await the work planned by the Pillar 2 standing group on this aspect of the covered bond regime. The Pillar 2 approach could influence the extent to which issuers use the recognised covered bond market so more clarity, as soon as possible, is needed. We have been asking for dialogue on this matter for some time.

Annex 1 mark up of draft Regulations

Annex 1a comments on mark up of draft Regulations

Annex 2 mark up of draft annex D

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STATUTORY INSTRUMENTS 2007 No. FINANCIAL SERVICES AND MARKETS The Recognised Covered Bond Regulations 2007

Made - - - -

Laid before Parliament

Coming into force - -

[1st January 2008]

The Treasury are a government department designated for the purposes of section 2(2) of the European Communities Act 1972¹ in relation to—
credit and financial institutions and the taking of deposits or other repayable funds from the public²; and

measures relating to securities and rights in securities³.

The Treasury, in exercise of the powers conferred by section 2(2) of that Act, make the following Regulations:

Part 1 INTRODUCTION

Citation, commencement and interpretation

1.

These Regulations may be cited as the Recognised Covered Bond Regulations 2007. Regulations 1 to 3, 6(1), 7(2), ~~9(1) and (2), 10, 14(2),~~ 17(1) and (2), ~~23(4), 13(2), 16(1) and (2), 22(4), 24(3(3), 25(3)24(3)~~ and ~~24(8), 354, 365, 432, 465~~ and ~~487~~ come into force on 3 December 2007 and the remainder of the Regulations come into force on 1st January 2008. [Comment: We are uncertain why there are two implementation dates]

In these Regulations—

"the Act" means the Financial Services and Markets Act 2000⁴;

"the 1986 Act" means the Insolvency Act 1986⁵;

"the 1996 Act" means the Housing Act 1996⁶;

"asset" means any property, right, entitlement or interest;

"asset transferor" means a person who transfers an asset pool to a separate owner (whether the issuer or another person);

"the Authority" means the Financial Services Authority;

"banking consolidation directive"⁷ means Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions;

"categories" has the meaning given by the third sub-paragraph of Article 22(4) of the UCITS directive;

"Commission" means the European Commission;

¹ 1972 c.68; amended by the Legislative and Regulatory Reform Act 2006 (c. 51).

² S.I. 2001/3495.

³ S.I. 2001/3057.

⁴ 2000 c.8.

⁵ 1986 c.45.

⁶ 1996 c.52.

⁷ O.J. No L 771, 30.6.2006, p.1.

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"centre of main interests" has the meaning given by Council Regulation (EC) No. 1346/2000 of 29 May 2000 relating to insolvency proceedings of companies and other corporate entities;

"covered bond" means ~~a bond in relation to which the repayment of the principal and interest is guaranteed by the owner~~;=

- (a) a bond in respect of which an asset pool held by an issuer/owner or separate owner shall, in the event of the insolvency of the issuer, be applied in priority (subject to the payment of expenses of winding-up of such asset pool) towards the satisfaction of claims of bondholders and persons providing services and/or credit to the issuer/owner or the separate owner; and**
- (b) where the issuer is not the owner, a bond in relation to which the repayment of the principal and interest is also guaranteed by ~~the~~ a separate owner;**

"credit institution" has the meaning given by Article 4(1) of the banking consolidation directive;

"EEA firm" and "EEA rights" have the meanings ascribed to them in Part I of Schedule 3 to the Act;

"home Member State" has the meaning given by Directive 2000/12/EC of the European Parliament and of the Council of 27 October 2000 relating to the taking up and pursuit of the business of credit institutions;

"owner" means the owner of the assets in the asset pool whether by right of his position under these Regulations or otherwise;

"insolvency" means:

- (c) with respect to an issuer or owner incorporated in England and Wales, its provisional liquidation, liquidation or administration in accordance with Parts I to VII of the 1986 Act (whether pursuant to the 1986 Act or any other enactment by virtue of which Parts I to VII of the 1986 Act may be applied in respect of any entity other than a company incorporated under the Companies Acts);**
- (d) with respect to an issuer or owner incorporated in Scotland *[to be completed]*;**
- (e) with respect to an issuer or owner incorporated in Northern Ireland *[to be completed]*; and**
- (f) with respect to an issuer whose home Member State is situated outside the United Kingdom, any collective insolvency proceeding under the law of such Member State which is analogous to a proceeding referred to in paragraph (a);**

~~has the meaning given by section 247(1) of the 1986 Act and includes *[receiverships]*;~~

"issuer/owner" means an issuer who is an owner;

"issuer" means a person who issues a recognised covered bond;

"liquidation" has the meaning given by section 247(2) of the 1986 Act;

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"recognised covered bond programme" means a programme for the issue of recognised covered bonds established under a set of contractual relationships by an issuer and recognised under regulation 6;

"register of issuers" means the register referred to in regulation 4(a);

"register of recognised covered bonds" means the register referred to in regulation 4(~~c~~b**);**

"register of recognised covered bond programmes" means the register referred to in regulation 4(b);

"recognised covered bond" means a category of covered bond recognised under regulation 6;

"separate owner" means an owner who is not the issuer;

"the Tribunal" means the Financial Services and Markets Tribunal established under section 132 of the Act; and

"UCITS directive"⁸ means Directive 85/611/EC of the Council of 20 December 1985 relating to undertakings for collective investment in transferable securities.

Asset pool

2. In these Regulations "asset pool" means—

sums derived from the issue of recognised covered bonds;

eligible property acquired with sums derived from the issue of recognised covered bonds;

sums derived from assets in the asset pool;

assets eligible property purchased with sums derived from assets in the asset pool; or

assets eligible property transferred by the issuer or any other asset transferor or allocated to the asset pool by the issuer in accordance with—

(i) regulation 1~~3~~**2**;

(ii) a direction of the Authority under regulation 2~~9~~**8**; or

(iii) an order of the court under regulation 3~~2~~**1**

recorded under regulation 1~~6(e)~~**5(b)**;

(a) any other eligible property ~~assets~~ transferred or allocated to the asset pool by the issuer or any other asset transferor from time to time whether for the purposes of over collateralisation or otherwise; and

(b) the benefit of all contractual rights acquired by the owner including under any hedging agreements in relation to the recognised covered bonds and any insurance contracts in relation to the asset pool,

and in each case recorded under regulation 15(b)(b)

Eligible property

3.

In these Regulations "**eligible property**" means an interest in —

⁸ O.J. No L 375, 31.12.85, p.3.

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- (a) exposures to or guaranteed by central governments, central banks, public sector entities, regional governments and local authorities in the EU;
- (b) exposures to or guaranteed by non-EU central governments, non-EU central banks, multilateral development banks, international organisations that qualify for the credit quality step 1 as set out in [this Annex VI of the Banking Consolidation Directive](#), ~~and exposures to or guaranteed by non-EU public sector entities, non-EU regional governments and non-EU local authorities that are risk-weighted as exposures to institutions or central governments and central banks according to points 8, 9, 14 or 15 respectively and that qualify for the credit quality step 1 as set out in this Annex, and exposures in the sense of this point that qualify as a minimum for the credit quality step 2 as set out in this Annex, provided that they do not exceed 20 % of the nominal amount of outstanding covered bonds of issuing institutions;~~
- (c) exposures to institutions that qualify for the credit quality step 1 as set out in [this Annex VI of the Banking Consolidation Directive](#). The total exposure of this kind shall not exceed 15 % of the nominal amount of outstanding covered bonds of the issuing credit institution. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of covered bonds shall not be comprised by the 15 % limit. ~~Exposures to institutions in the EU with a maturity not exceeding 100 days shall not be comprised by the step 1 requirement but those institutions must as a minimum qualify for credit quality step 2 as set out in this Annex;~~
- (d) loans secured by residential real estate ~~or shares in Finnish residential housing companies as referred to in point 46~~ up to the lesser of the principal amount of the liens that are combined with any prior liens and 80 % of the value of the pledged properties or by ~~senior units issued by French Fonds Communs de Créances or by~~ [exposures to equivalent](#) securitisation entities governed by the laws of a Member State securitising residential real estate exposures provided that at least 90 % of the assets of such ~~Fonds Communs de Créances or of equivalent~~ securitisation entities governed by the laws of a Member State are composed of mortgages [originated by the issuer or an affiliate of the issuer](#) that are combined with any prior liens up to the lesser of the principal amounts due under the [exposures](#) units, the principal amounts of the liens, and 80 % of the value of the pledged properties and the [exposures](#) units qualify for the [most favourable rating within](#) credit quality step 1 as set out in [this Annex VI of the Banking Consolidation Directive](#) ~~where such units do not exceed 20 % of the nominal amount of the outstanding issue~~. Exposures caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit;
- (e) loans secured by commercial real estate or ~~shares in Finnish housing companies as referred to in point 52~~ up to the lesser of the principal amount of the liens that are combined with any prior liens and 60 % of the value of the pledged properties or by ~~senior units issued by French Fonds Communs de Créances or by equivalent~~ [exposures to](#) securitisation entities governed by the laws of a Member State securitising commercial real estate exposures provided that, at least, 90 % of the assets of such ~~Fonds Communs de Créances or of equivalent~~ securitisation entities governed by the laws of a Member State are composed of mortgages [originated by the issuer or an affiliate of the issuer](#) that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60 % of the value of the pledged properties and the [exposures](#) units qualify for the [most favourable rating within](#) credit quality step 1 as set out in [this Annex VI of the Banking Consolidation Directive](#) ~~where such units do not exceed 20 % of the nominal amount of the outstanding issue~~. The competent authorities may recognise loans secured by commercial real estate as eligible where the Loan to Value ratio of 60 % is exceeded up to a maximum level of 70 % if the value of the total assets pledged as collateral for the covered bonds exceed the nominal amount outstanding on the covered bond by at least 10 %, and the bondholders' claim meets the legal certainty requirements set out in [Annex VIII of the Banking Consolidation Directive](#). ~~The bondholders' claim must take priority over all other claims on the collateral~~. Exposures caused by

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transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged properties of the senior units or debt securities shall not be comprised in calculating the 90 % limit, ~~or~~

~~(f) loans secured by ships where only liens that are combined with any prior liens within 60 % of the value of the pledged ship;~~

~~a) eligible assets mentioned in paragraph 68 of Annex VI of the banking consolidation directive;~~

loans to a registered social landlord secured—

- (i) over housing accommodation; or
- (ii) by rental income from housing accommodation;

loans to a person providing on-loans directly to a registered social landlord with such on-loans secured—

- (i) over housing accommodation; or
- (ii) by rental income from housing accommodation;

loans to a project company of a project which is a public-private partnership project secured by payments made by a public body with step-in rights;

loans to a person providing loans directly to a project company of a project which is a public-private project secured by payments made by a public body with step-in rights;
or

~~other assets held in relation to an obligation of~~ other assets held in relation to a body that has a credit assessment applied to it—

- (i) by an ECAI recognised as eligible for exposure risk-weighting purposes under the 2006 Regulations⁹; and
- (ii) which is equivalent to the most favourable rating within credit quality step 1 ~~or 2~~ on the credit quality assessment scale set out in Annex VI to the banking consolidation directive;

Eligible property must be situated in—

- (i) an EEA State;
- (ii) ~~Switzerland;~~ any of Australia, Canada, The Channel Islands, The Isle of Man, Japan, New Zealand, Switzerland and the United States of America, except if the issuer is a person within regulation 6(2)(b), where the asset pool held by the separate owner may only be eligible property situated in the United Kingdom.
- ~~(iii) Switzerland;~~
- ~~(iv) countries or territories listed in section 426 of the 1986 Act;~~

⁹ S.I. 2006/3221.

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~~(v) countries or territories listed in regulations made under section 426 of the 1986 Act; or~~

~~(vi) countries or territories which have given effect to the UNCITRAL Model Law.~~

In this regulation—

"2006 Regulations" means the Capital Requirements Regulations 2006;

"ECAI" has the meaning given by regulation 21 of the 2006 Regulations;

"exposure risk-weighting purposes" has the meaning given by regulation 21 of the 2006 Regulations;

"housing accommodation" has the meaning given by section 63 of the 1996 Act;

"project company" has the meaning given by paragraph 4H of Schedule A1 to the 1986 Act;

"public body" means a body which exercises public functions;

"public-private partnership projects" has the meaning given by paragraph 4I of Schedule A1 to the 1986 Act;

"registered social landlord" means a body registered as a social landlord under Part 1 of the 1996 Act;

"step-in rights" has the meaning given by paragraph 4J of Schedule A1 to the 1986 Act; and

~~"the UNCITRAL Model Law" means the Model Law on cross-border insolvency as adopted by the United Nations Commission on International Trade on 30th May 1997.~~

Unless otherwise defined, expressions used in these Regulations and the banking consolidation directive have the same meaning as given in that directive.

Part 2 **RECOGNITION**

Maintenance of registers

4. The Authority must maintain and in such manner and at such time as it may determine publish a register of—

- a) issuers; and
- b) [recognised covered bond programmes; and](#)
- c) recognised covered bonds.

Notification of the Commission

5.

1) The Authority must in such manner and at such time as it may determine notify the Commission of—

- a) issuers on the register in regulation 4(a);
 - b) recognised covered [bond programmes on the register in regulation 4\(b\);](#)
- recognised covered bonds on the register in regulation 4([cb](#)); and
- the status of the guarantees offered.

In this regulation **"the status of the guarantees offered"** has the meaning given by the third subparagraph of Article 22(4) of the UCITS directive.

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Applications for recognition

6.

1) Recognition—

as an issuer; or

for a recognised covered bond programme; or

for a recognised covered bond

may be granted by admission to the register of issuers or to the register of covered bond programmes or to the register of recognised covered bonds only on an application made to the Authority in such manner as the Authority may direct.

The Authority may not entertain an application for recognition unless ~~it~~the proposed issuer is:

- a) ~~The Authority may not entertain an application for recognition unless it is made by~~ a person whose registered office is in the United Kingdom and whose home Member State is the United Kingdom which is authorised under Part 4 of the Act to carry on the regulated activity referred to in article 5 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001; ~~or~~¹⁰.
- b) an EEA firm authorised by its home state regulator for the purposes of the banking consolidation directive which exercises EEA rights in the United Kingdom to accept deposits pursuant to Schedule 3 of the Act and which does not propose to issue recognised covered bonds as an issuer/owner.

The Authority may grant an application for recognition if it is satisfied that the ~~applicant issuer, the programme~~issuer and the owner—

- a) ~~will~~ comply with the requirements imposed upon an issuer or an owner, as the case may be, by these Regulations; and

~~complies~~ with any other requirements imposed by the Authority in relation to the application.

If it appears to the Authority that the ~~applicant issuer, the programme~~ and the owner comply with the requirements in paragraph (3), it may recognise—

- a) the ~~applicant as an~~ issuer by adding him~~it~~ to the register of issuers; or
- b) the programme by adding it to the register of recognised covered bond programmes; or

the category of covered bond as a recognised covered bond by adding it to the register of recognised covered bonds.

An application for recognition may be refused if, for any reason relating to the ~~applicant issuer, the programme~~ or the owner, the Authority considers that

¹⁰ S.I. 2001/544.

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granting it would be detrimental to the interests of investors in the proposed recognised covered bonds or holders of outstanding recognised covered bonds issued by the issuer..

7.

- 1) At any time after receiving an application for recognition and before determining it, the Authority may require the ~~applicant~~ proposed issuer to provide such further information as it reasonably considers necessary to enable it to determine the application.

Information which the Authority requires in connection with an application must be provided in such form, or verified in such manner, as the Authority may direct.

Different directions may be given, or requirements imposed, by the Authority with respect to different applications.

- (a) The regulatory objectives of the Authority with respect to these regulations shall be (i) the promotion of market confidence in recognised covered bonds, and (ii) the protection of existing and prospective holders of recognised covered bonds.
- (b) In discharging its functions under these regulations, the Authority shall, so far as is reasonably practicable, act in a manner which is compatible with such regulatory objectives and which the Authority considers most appropriate for the purpose of meeting those objectives.
- (c) In discharging its functions under these regulations, the Authority must have regard to –
 - (i) the need to use resources received from recognised issuers and/or owners in the most efficient and economic way;
 - (ii) the responsibilities of those who manage the affairs of issuers and owners to whom these regulations apply;
 - (iii) the principle that a burden or restriction which is imposed on a person to whom these regulations apply, or on the establishment of a recognised covered bond programme and/or the issuance of recognised covered bonds, should be proportionate to the benefits, considered in general terms, which are expected to result from the imposition of that burden or restriction;
 - (iv) the desirability of facilitating innovation in connection with the establishment of a recognised covered bond programme and/or the issuance of recognised covered bonds; and
 - (v) the international character of financial services and markets and the desirability of maintaining the competitive position of the United Kingdom.

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Decision on the application

8.

- 1) The Authority must notify the ~~applicant~~issuer of its decision on an application for recognition as an issuer, on the establishment of a recognised covered bond programme, or in respect of the first recognised covered bond to be issued by the issuer under that programme.—

~~as an issuer, or in respect of the first recognised covered bond to be issued by the issuer, b~~
before the end of a period of ~~three~~ six months beginning with the date on which the application is received; or

- ~~2) (a) before the end of a period of [six] months in respect of the issue of a recognised covered bond (other than one falling within paragraph (a) above) by an already recognised issuer, before the end of a period of one month beginning with the date on which the application is received; or~~

~~(b) if within that period the Authority has required the applicant to provide further information in connection with the application, before the end of the period of [six] months one month beginning with the date on which that information is provided.~~

The ~~applicant~~issuer may withdraw ~~his~~an application, by giving the Authority written notice, at any time before the Authority determines it.

- 3) If the Authority decides to grant an application for recognition in respect of an issuer or a recognised covered bond, it must give the ~~applicant~~issuer written notice of its decision.
- 4) If the Authority proposes to refuse an application for recognition either as an issuer, or for a recognised covered bond programme or for a recognised covered bond, ~~either as an issuer or for a recognised covered bond~~, it must give the ~~applicant~~issuer a warning notice.

The Authority must, having considered any representations made in response to the warning notice—

- a) if it decides to refuse the application for recognition, give the ~~applicant~~issuer a decision notice; or

if it grants the application, give the ~~applicant~~issuer written notice of its decision.

If the Authority decides to refuse an application for recognition, the ~~applicant may refer the matter to the Tribunal.~~

Change of owner

9.—

- ~~(1) Where an owner proposes to transfer the asset pool to a new owner he must make arrangements to give the Authority—~~

~~(a) notice of the proposed change of ownership; and~~

~~(b) such information in respect of the proposed new owner as the Authority may direct.~~

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- ~~(2) The information required in paragraph (1) must be given at such time, in such form and verified in such manner as the Authority may direct.~~
- ~~(3) If it appears to the Authority that the proposed new owner will comply with the requirements in regulation 6(3)(a) it must give the owner written notice of its decision before the end of a period of [3] months beginning with the date on which the information required by paragraph (1) is provided.~~
- ~~(4) If it appears to the Authority that the proposed new owner will be unable to comply with the requirements in regulation 6(3)(a) it may direct the owner not to transfer the asset pool to that proposed new owner.~~
- ~~(5) The owner may not transfer the asset pool to a proposed new owner—~~
- ~~(a) before it has received a written notice under paragraph (3);~~
 - ~~(b) if a warning notice has been given and a notice of discontinuance has not been given; or~~
 - ~~(c) if the matter has been referred to the Tribunal.~~
- ~~(6) If the Authority proposes to make a direction under paragraph (4), it must give the owner a warning notice.~~
- ~~(7) The Authority must, having considered any representations made in response to the warning notice—~~
- ~~(a) if it decides to do so, make a direction under paragraph (4); or~~
 - ~~(b) if it decides not to give a direction, give the owner a notice of discontinuance.~~
- ~~(8) If the Authority gives a direction under paragraph (4), the owner issuer may refer the matter to the Tribunal.~~

Guidance

~~10.~~ The Authority's powers to give guidance under section 157 of the Act (guidance) are exercisable in relation to any persons subject to these Regulations but with the following modifications—

- a) in subsection (1), omit paragraphs (a) and (c);

for "rules" substitute "**an obligation or requirement imposed by or under these Regulations**";

in subsection (3), omit "**as they apply to proposed rules**";

in subsection (3), for "**a regulated person**" substitute "**any person subject to these Regulations**";

omit subsection (6).

Annex 1

Part 3

RECOGNISED COVERED BOND ISSUERS AND ISSUER/OWNERS

Prohibition

~~11.~~ No person may issue a recognised covered bond or be an issuer/owner, unless—

- ~~(a) — it is a credit institution with its head office or branch office situated in the United Kingdom;~~
- ~~(b) —~~ (a) he ~~it~~ is recognised by admission to the register of issuers;
- ~~(c) —~~ it is issued under a recognised covered bond programme; and
- ~~(d) —~~ (b) the ~~category of~~ covered bond is on the register of recognised covered bonds.

Acting without recognition

~~12.~~

1) If a person purports to issue a recognised covered bond—

- a) without being recognised by admission to the register of issuers; or

by issuing a category of covered bond that is not on the register of recognised covered bonds

he is taken to have contravened a requirement imposed upon him by or under these Regulations.

The contravention does not—

- a) make the person guilty of an offence;
- make any transaction void or unenforceable; or
- give rise to any right of action for breach of statutory duty.

General requirements

~~13.~~

1) An issuer/owner must, in relation to all sums derived from the issue of a recognised covered bond—

- a) ~~transfer, or where the owner is the issuer/owner,~~ allocate, such sums to an asset pool; ~~or~~ and
- b) ~~use such sums to acquire eligible property and transfer, or where the owner is the issuer allocate, that if an issuer/owner, in exchange for the sums referred to in paragraph (a) ,~~ allocate eligible property to ~~an~~ an asset pool; ~~or~~

An issuer, if there is a separate owner, must lend the sums referred to in paragraph (a) to the separate owner so that the loan proceeds form part of the asset pool and ensure that such separate owner uses such loan proceeds to purchase eligible property from an asset transferor.

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An issuer must ensure that

- a) the asset pool is, during the whole period of validity of the recognised covered bond, capable of covering—
 - i) claims attaching to the recognised covered bond;
 - ii) sums required for the maintenance, administration and winding up of the asset pool; and
- b) there is timely payment of claims attaching to the recognised covered bond due to the recognised covered bond holders.

But paragraph (2) does not apply in the event of the insolvency of the issuer.

~~(2) — An issuer must ensure that there is timely payment of claims attaching to the recognised covered bond due to the recognised covered bond holders.~~

Notification requirements

~~14.~~

1) An issuer must give the Authority such information in respect of—

- a) any recognised covered bond ~~he~~it issues; ~~and~~
- b) the steps ~~he~~it has taken to comply with regulation ~~13~~2;

~~as the Authority may direct.~~

- ~~(c)~~ circumstances where the asset pool is not capable or is not likely to be capable of meeting the requirements in regulation 13(2); and
- ~~(d)~~ any modifications proposed to be made to the terms of a recognised covered bond programme or a covered bond issue which may or would have the effect of that programme or issue ceasing to meet the requirements of these regulations.

The information required in paragraph (1) must be given at such times, in such form and verified in such manner as the Authority may direct.

Part 4

THE SEPARATE OWNER OF THE ASSET POOL

Prohibition

~~15.~~

~~(1) —~~ No person may be or become ~~ana~~ separate owner unless it has its relevant registered office in the United Kingdom. A separate owner must have its registered office and its centre of main interests (COMI) in the United Kingdom if the issuer is a UK branch of an EEA registered bank. The Issuer shall ensure that the separate owner informs the Authority if it becomes aware that such requirements are not met.

~~(2) — In this regulation "relevant office" means —~~

Annex 1

~~(a) — in relation to a person which has a registered office, his registered office; or~~

~~(b) — in relation to any other person, his head office.~~

~~(3) — The owner may be the issuer or a person other than the issuer.~~

Requirements relating to the asset pool

~~16. The~~ A separate owner must make arrangements for the maintenance and administration of the asset pool so that—

~~(a) — during the whole period of the validity of a recognised covered bond —~~

~~(i) — the asset pool is capable of covering —~~

~~(A) — all claims attaching to that bond; and~~

~~(B) — sums required for the maintenance, administration and winding up of the asset pool; and~~

~~(ii) — there is timely payment of claims attaching to that bond to the recognised covered bond holder;~~

(a) ~~(b)~~ on the separate owner's insolvency, the asset pool is used to reimburse the principal and pay accrued interest to the ~~holders of the~~ recognised covered ~~bond~~ bondholders; and

(b) ~~(c)~~ a record is kept of each asset in the asset pool.

Notification requirements

~~17.~~

1) ~~An~~ A separate owner must make arrangements to give the Authority such information in respect of— the assets in the asset pool as the Authority may direct.

~~(a) — his compliance with regulation 16; and~~

~~(b) — the assets in the asset pool as the Authority may direct.~~

The information required in paragraph (1) must be given at such times, in such form and verified in such manner as the Authority may direct.

~~as the Authority may direct.~~

~~18. —~~

~~(1) — This regulation applies where the owner is the issuer.~~

~~(2) — Where the asset pool is not capable or is not likely to be capable of meeting the requirements in regulation 16(a) or (b) the owner must inform the Authority.~~

~~19. —~~

~~(1) — This regulation applies where the owner is a person other than the issuer.~~

~~(2) — Where the asset pool is not capable or is not likely to be capable of meeting the requirements in regulation 16(a) or (b) the owner must inform the issuer and the Authority.~~

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Transfer Voluntary transfer to new owner

- (1) Where an owner proposes voluntarily to transfer the asset pool to a new separate owner he must make arrangements to give the Authority—

 - (a) notice of the proposed change of ownership; and
 - (b) such information in respect of the proposed new separate owner as the Authority may direct.
- (2) The information required in paragraph (1) must be given at such time, in such form and verified in such manner as the Authority may direct.
- (3) If it appears to the Authority that the proposed new separate owner complies with the requirements in regulation 6(3)(a) it must give the ~~original~~ existing owner written notice of its decision before the end of a period of one month beginning with the date on which the information required by paragraph (1) is provided.
- (4) If it appears to the Authority that the proposed new separate owner is unable to comply with the requirements in regulation 6(3)(a) it may direct the ~~original~~ existing owner not to transfer the asset pool to that proposed new separate owner.
- (5) ~~The original~~An owner may not transfer the asset pool to a proposed new separate owner—

 - (a) before it has received a written notice under paragraph (3);
 - (b) if a warning notice has been given and a notice of discontinuance has not been given; or
 - (c) if the matter has been referred to the Tribunal.
- (6) If the Authority proposes to make a direction under paragraph (4), it must give the ~~original~~ existing separate owner a warning notice.
- (7) The Authority must, having considered any representations made in response to the warning notice—

 - (a) if it decides to do so, make a direction under paragraph (4); or
 - (b) if it decides not to give a direction, give the ~~original~~ existing owner a notice of discontinuance.

If the Authority gives a direction under paragraph (4), the ~~original~~ existing separate owner may refer the matter to the Tribunal.

Obligatory transfer to new separate owner

~~20.~~

- 1) This regulation applies ~~where the owner is the~~ to an issuer/owner.

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Where an issuer/owner is failing to satisfy a requirement to maintain adequate financial resources imposed under the Act, it must assign or transfer—

- a) all interests in the assets in the asset pool; and
- b) the benefits and obligations under all contracts relating to the asset pool

~~to a person other than the issuer.~~

to a separate owner.

Change of owner

~~21.~~

- 1) A new separate owner must provide written notice to the Authority of a change of ownership within [one] month of the date on which the change became effective.

~~(2) — These Regulations apply to any new owner as they applied to the original owner. The issuer must confirm in writing to the Authority that the centre of main interests of a new separate owner is located in the United Kingdom.~~

Material changes to the covered bond programme

- (1) Where an issuer proposes to make material changes to the contractual terms of the programme he must make arrangements to give the Authority—

(a) notice of the proposed change; and

(b) such information in respect of the proposed change as the Authority may direct.

- (2) The information required in paragraph (1) must be given at such time, in such form and verified in such manner as the Authority may direct.

- (3) If it appears to the Authority that the proposed change complies with the requirements in the regulations it must give the issuer written notice of its decision before the end of a period of one month beginning with the date on which the information required by paragraph (1) is provided.

- (4) If it appears to the Authority that the proposed change would make the programme unable to comply with the requirements of the regulations it will direct the issuer not to make the change.

- (5) The issuer may not make the proposed change —

(a) before it has received a written notice under paragraph (3);

(b) if a warning notice has been given and a notice of discontinuance has not been given; or

(c) if the matter has been referred to the Tribunal.

- (6) If the Authority proposes to make a direction under paragraph (4), it must give the ~~original separate owner~~ issuer a warning notice.

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(7) The Authority must, having considered any representations made in response to the warning notice—

if it decides to do so, make a direction under paragraph (4); or

if it decides not to give a direction, give the issuer ~~existing owner~~ a notice of discontinuance.

(8) If the Authority gives a direction under paragraph (4), the issuer ~~existing separate owner~~ may refer the matter to the Tribunal.

Part 5 INSOLVENCY

Arrangements

~~22.~~

1) This regulation applies ~~where the owner is the~~ to an issuer/owner.

No interest in the asset pool may form the subject matter of—

- a) a voluntary arrangement under Part 1 of the 1986 Act; or
- b) a compromise or arrangement made under Part 26 of the Companies Act 2006¹¹ [Note this part of the Companies Act will not be in force until April 2008]

made between the issuer/owner and his creditors or any class of them.

In this regulation "**voluntary arrangement**" has the meaning given by section 1 of the 1986 Act.

Administration

~~23.~~

1) This regulation applies ~~where the owner is the~~ to an issuer/owner.

The administrator of an issuer/owner must not deal with the asset pool except for the purposes of regulation 1~~6~~2.

But paragraph (2) does not apply to any assignment or transfer of—

- a) all interests in the assets in the asset pool; and
- b) the benefits and obligations under all contracts relating to the asset pool

to a ~~person~~ separate owner other than the issuer/owner.

[The administrator must, at such times and in such manner as the Authority may direct, ~~give written confirmation to~~ notify the Authority ~~that whether or not~~ the asset pool complies with the requirements ~~at~~ of regulation 1~~6~~2.]

¹¹ 2006 c.46.

¹⁰ 2006 c.46.

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Provisional liquidation

~~24.~~

- 1) This regulation applies ~~where the owner is the~~ to an issuer/owner.

The provisional liquidator of an issuer/owner must not deal with the asset pool except for the purposes of regulation 1~~6~~2.

But paragraph (2) does not apply to any assignment or transfer of—

- a) all interests in the assets in the asset pool; and
 - b) the benefits and obligations under all contracts relating to the asset pool
- to a person other than the issuer/owner.

[The provisional liquidator must, at such times and in such manner as the Authority may direct, ~~give written confirmation to~~ notify the Authority ~~that~~ whether or not the asset pool complies with the requirements at regulation 1~~6~~2.]

Winding up of ~~the~~ an issuer/owner

~~25.~~

- 1) This regulation applies ~~where the owner is the~~ to an issuer/owner.

On the application of the liquidator, the Authority may give a direction in writing extending the protected period.

The application shall be made in such manner as the Authority may direct.

[During the protected period the asset pool is to be dealt with in accordance with these regulations and is not to be treated as assets of the issuer/owner in ~~the~~its winding up.]

During the protected period the liquidator must not deal with the asset pool except for the purposes of regulation 1~~6~~2.

But paragraph (5) does not apply to an assignment or transfer under paragraph (7).

The liquidator must take all reasonable steps, before the end of the protected period, to assign or transfer—

- a) all interests in the assets in the asset pool; and
- b) the benefits and obligations under all contracts relating to the asset pool, ~~to a person other than the issuer.~~ to a separate owner.

Upon such assignment or transfer, the separate owner shall be deemed without further formality to have assumed all of the obligations and liabilities of the issuer under or in connection with:

- i) the recognised covered bonds;
- ii) the provision of services to the issuer (including hedging arrangements) in relation to the covered bond for the benefit of recognised covered bondholders;

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- iii) contracts in relation to the provision of credit to the issuer in respect of its obligations to any of the persons referred to in (a) and (b) above; and
- iv) all other contracts relating to the asset pool,

and such obligations and liabilities shall be enforceable against it to the same extent that they would have been enforceable against the issuer prior to such assignment or transfer. Upon such assignment or transfer, such obligations and liabilities shall no longer be enforceable against the liquidator.

~~to a separate owner. Payment of the purchase price for such assignment or transfer shall be deferred until the claims referred to in regulation 27(i) and all other creditors in respect of the asset pool have been satisfied or provided for in full.~~

The liquidator must, at such times and in such manner as the Authority may direct, give written notify confirmation to the Authority ~~that~~whether or not the asset pool complies with the requirements ~~at~~of regulation 162.1

If a transfer and assignment is not made in accordance with paragraph (7), the asset pool shall be ~~wound up~~dealt with in accordance with regulation 287.

In this regulation "**the protected period**", in relation to an issuer/owner, means the period of ~~one~~yeartwo years beginning with the date on which the issuer/owner goes into liquidation.

Transfer of interests to ~~the person holding the asset pool~~a separate owner ~~26.~~

- 1) This regulation applies ~~where the owner is a person other than the issuer~~to a separate owner.

Where ~~the issuer~~an asset transferor holds ~~any the bare legal title or any other~~any interest on behalf of ~~the~~a separate owner in an asset in the asset pool, the liquidator appointed to wind up ~~the issuer~~an asset transferor must assist in the transfer of that bare legal title or other interest to the separate owner.

Receivers

~~Paragraph (2) applies in the case of an owner, where a receiver is appointed on behalf of the holders of any fixed or floating charges created by the owner over the asset pool. If any property comprising the asset pool is charged:~~

- (a) as security for claims other than those referred to in Regulation 28~~6(4)(1)~~;
and
- (b) in priority to any charge over such property granted to secure the claims referred to in Regulation 28 ~~6(4)(1)~~.

("prior-ranking charges") then in the event that any such prior-ranking charges are realised (whether by the chargeholder or by any person appointed on its behalf) at any time when the owner is not in the course of being wound up, the proceeds of realisation of such prior-ranking charges shall be applied to satisfy the claims of those persons referred to in Regulation 28 ~~6(4)(1)~~ in the order of priority specified in Regulation 28 ~~6(4)(1)~~.

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Winding up of an owner

~~28.~~

~~Where an owner is in the process of being wound up or if~~ possession is taken, by or on behalf of ~~a fixed or floating charge the~~ holder of any debentures created by such owner, of any property comprised in or subject to the floating charge, ~~created thereunder~~ and the owner is not at that time in ~~the~~ course of being wound up, the claims

~~e) (a) — Where an asset poolowner is included in a winding in the process of being wound up, the claims of —~~

recognised covered bond holders; and

(b) — persons providing services or securities to the issuer (including any providers of hedging arrangements) in relation to the recognised covered bond for the benefit of recognised covered bondholders ; and

(c) — persons providing credit to the issuer in respect of its obligations to any of the persons referred to in (a) and (b) above.

shall be paid from the asset pool in priority to all other creditors.

~~(2) — The claims in paragraph (1) shall rank equally among themselves after the expenses of the winding up and shall be paid in full, unless the asset pool is insufficient to meet them, in which case they abate in equal proportions.~~

~~(3) — In so far as the asset pool available for payment of the claims in paragraph (1) is insufficient to meet them, those claims have priority over the claims of holders of any fixed or floating charges created by the owner over the asset pool, and shall be paid accordingly out of any property comprised in or subject to that charge.~~

~~(4) — All assets remaining in the asset pool after the payment of recognised covered bondholders and all other creditors shall be the property of the issuer.~~

Part 6 ENFORCEMENT

Authority's power to give directions

~~29.~~

1) This regulation applies if it appears to the Authority that a person has failed, or is likely to fail, to comply with any obligation or requirement imposed on it by or under these Regulations.

The Authority may direct the person —

a) to take specified steps for the purpose of securing his compliance with any requirement or obligation imposed upon it by or under these Regulations;

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- b) to wind up the asset pool in accordance with regulation ~~28~~⁷

A direction under this regulation is enforceable, on the application of the Authority, by an injunction or, in Scotland, by an order for specific performance under section 45 of the Court of Session Act 1988¹².

Revoking recognition

~~30.~~

- 1) The recognition of an issuer may be revoked by the removal of the issuer from the register of issuers, at the request, or with the consent of the issuer.

If it appears to the Authority that an issuer is failing, or has failed, to comply with any requirement or obligation imposed on it by or under these Regulations, the Authority may revoke that issuer's recognition by removing it from the register of issuers.

But these Regulations apply to a person whose recognition has been revoked in relation to any recognised covered bond that was issued prior to the date on which the revocation took effect, as if he were an issuer.

Directions and revocation: procedure

~~31.~~

- 1) Before—

- a) giving a direction under regulation ~~29~~⁸; or
- b) revoking the recognition of an issuer under regulation ~~30~~²⁹

the Authority must give a warning notice to the person concerned.

If, having considered any representations, the Authority decides to—

- a) make the direction; or
- b) revoke the recognition

the Authority must give that person a decision notice.

If the Authority decides not to—

- a) make a direction; or
- b) revoke the recognition

it must give that person written notice of its decision.

If the Authority decides to—

- a) make a direction; or
- b) revoke the recognition

the person concerned may refer the matter to the Tribunal.

¹² 1988 c.36.

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Powers of the court

~~32.~~

- 1) If, on the application of the Authority, the court is satisfied that—
 - a) there is a reasonable likelihood that any person will contravene a requirement imposed by or under these Regulations; or
 - b) any person has contravened a requirement imposed by or under these Regulations and that there is a reasonable likelihood that the contravention will continue or be repeated,the court may make an order restraining (or in Scotland an interdict prohibiting) the contravention.

If, on the application of the Authority, the court is satisfied that—

- a) any person has contravened a requirement imposed by or under these Regulations, and
 - b) there are steps which could be taken for remedying the contravention,
- the court may make an order requiring that person, and any other person who appears to have been knowingly concerned in the contravention, to take such steps as the court may direct to remedy it.

The jurisdiction conferred by this regulation is exercisable by the High Court and the Court of Session.

In paragraph (2), references to remedying a contravention include references to mitigating its effect.

Financial penalties

~~33.~~

- 1) If the Authority considers that a person has contravened a requirement imposed on him by or under these Regulations, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate.

A penalty under this section is payable to the Authority.

The Authority may not take action against a person under this regulation after the end of the period of two years beginning with the first day on which it knew of the contravention unless proceedings against that person, in respect of the contravention, were begun before the end of that period.

For the purposes of paragraph (3)—

- a) the Authority is to be treated as knowing of a contravention if it has information from which the contravention can reasonably be inferred; and
- b) proceedings against a person in respect of a contravention are to be treated as begun when a warning notice is given to him under regulation 34.

~~34.~~

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- 1) If the Authority proposes to impose a penalty under regulation ~~33~~², it must give the person concerned a warning notice.

The warning notice must state the amount of the penalty.

If, having considered any representations made in response to the warning notice, the Authority decides to impose a penalty under regulation 33, it must without delay give the person concerned a decision notice.

The decision notice must state the amount of the penalty.

If the Authority decides to impose a penalty on a person under regulation 33, he may refer the matter to the Tribunal.

~~35.~~ Sections 210 (statements of policy) and 211 (statements of policy: procedure) of the Act are to apply for the purposes of these Regulations as they apply for the purposes of Part 14 of the Act but with the modification that in section 210(1), at the end add—

"(c) the amount of penalties under the Recognised Covered Bond Regulations 2007."

~~36.~~ Paragraph 16 of Schedule 1 (penalties) to the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act but with the following modifications—

- a) for "**the Act**" substitute "**the Regulations**";
- b) in subparagraph (2) for "**authorised person**" substitute "**issuers**";
- c) omit subparagraph (3); and
- d) at the end, add—

"(14) In this paragraph "**issuer**" has the meaning given by regulation 1(2) of the Recognised Covered Bond Regulations 2007."

Offence of misleading the Authority

~~37.~~ Section 398 (misleading the Authority: residual cases) of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act but with the following modifications—

- a) for "**this Act**" substitute "**the Recognised Covered Bond Regulations 2007**"; and
- b) omit subsection (2).

~~38.~~ Section 400 (offences by bodies corporate) of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act.

~~39.~~ Section 401 (proceedings for offences) of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act but with the modification that for "**the Act**" substitute "**the Recognised Covered Bond Regulations 2007**".

Part 7 THE TRIBUNAL

Annex 1

Functions of the Tribunal

~~40.~~ The Tribunal is to have the functions conferred on it by these Regulations.

Hearings and appeals

~~41.~~ Part IX of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act.

Part 8 MISCELLANEOUS

Functions of the Authority

~~42.~~ The Authority is to have the functions conferred on it by these Regulations.

Authority's exemption from liability in damages

~~43.~~

- 1) Neither the Authority nor any person who is, or is acting as, a member, officer or member of staff of the Authority is to be liable in damages for anything done or omitted in the discharge, or purported discharge, of the Authority's functions.

Paragraph (1) does not apply—

- a) if the act or omission is shown to have been in bad faith; or
- b) so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.¹³

Authority's investigation powers

~~44.~~ Section 165 (Authority's power to require information) of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act but with the following modifications—

- a) for "**an authorised person**" substitute "**a person to whom the Regulations apply**";
- b) at the end, add—

"(12) "**The Regulations**" means the Recognised Covered Bond Regulations 2007."

~~45.~~ Section 166 (reports by skilled persons) of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act but with the modification that in subsection (2) at the end add—

"(e) a person to whom the Recognised Covered Bond Regulations apply,".

Disclosure of information

~~46.~~

- 1) Sections 348 (restrictions on disclosure of confidential information by the Authority), 349 (exceptions to section 348) and 352 (offences) apply to confidential information disclosed under these Regulations as they apply to confidential information under the Act.

¹³ 1998 c.42.

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In this regulation "**confidential information**" has the meaning given by section 348 of the Act.

Warning notices and decision notices

~~47.~~ Part XXVI of the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act.

Fees

~~48.~~ Paragraph 17 of Schedule 1 to the Act is to apply for the purposes of these Regulations as it applies for the purposes of the Act, but with the following modifications—

- a) in subparagraph (1), omit paragraphs (b) and (c); and
- b) omit subparagraph (3).

Modifications of primary legislation

~~49.~~ Schedule 1 (which modifies the 1986 Act) has effect.

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SCHEDULE 1 MODIFICATIONS TO THE 1986 ACT

Regulation [49]

Administration orders

~~50.~~

- 1) This paragraph applies ~~where the owner is the~~ to an issuer/owner.

Where a person is appointed as administrator of an issuer/owner, Part 2 of the 1986 Act (administration orders) applies with the following modifications—

- a) in subsection 8(3)—
 - (i) omit paragraphs (a) to (d) as they apply in relation to an asset pool; and
 - (ii) at the end add—

"(3A) The purposes for whose achievement an administration order may be made in relation to an asset pool are—

 - (a) the survival in compliance with regulation 1~~6~~5 of the asset pool as part of the company as a going concern; or
 - (b) the assignment or transfer of—
 - (i) all interests in the asset pool; and
 - (ii) the benefits and obligations under all contracts relating to the asset pool

to a person other than the issuer~~,~~/owner,
and the order shall specify the purpose or purposes for which it is made."
- b) in section 14, after subsection (1) insert—

"(1A) But the administrator of an issuer/owner must in relation to the asset pool exercise the powers in subsection (1) subject to the requirements of regulation 16."
- c) in section 15, after subsection (2) insert—

"(2A) Where the administrator makes an application under subsection (2) in relation to an asset pool, the court must be satisfied that the disposal would be likely to promote one or more of the purposes under section 8(3A) specified in that order."
- d) in section 22, in subsection (2) at the end insert—

"(f) for issuer/owners, a record of the assets in the asset pool required by regulation 1~~6~~5(~~eb~~)."

Winding up

~~51.~~

- 1) This paragraph applies ~~where the owner is the~~ to an issuer/owner.

Where an issuer goes into liquidation Part 4 of the 1986 Act (winding up of companies registered under the Companies Acts) applies with the following modifications—

- a) in section 87 (effect on business and status of company), at the end add—

"(3) But during the protected period an issuer/owner shall carry on its business in relation to the asset pool under the 2007 Regulations until an

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assignment or transfer is made under regulation 25(7) or the asset pool is wound up under regulation 278."

- b) in section 127 (avoidance of property dispositions), after subsection (1) insert—

"(1A) But subsection (1) shall not apply to an assignment or transfer of the asset pool under regulation 243(3) or 245(7)."

- c) in section 143 (general functions in winding up by the court), after subsection insert—

"(1A) But the functions of a liquidator of an issuer/owner are, in relation to the asset pool—

to comply with regulation 165; and

to assign or transfer during the protected period—

- (i) all interests in the assets in the asset pool; and
- (ii) the benefits and obligations under all contracts relating to the asset pool to a person other than the issuer-"/owner."

(1B) In the event that no assignment or transfer is made during the protected period, the functions of the liquidator are to secure that the assets in the asset pool are got in, realised and distributed under regulation 278 of the 2007 Regulations."

- d) in section 135 (appointment and powers of provisional liquidator), at the end insert—

"(6) But the functions of a provisional liquidator of an issuer/owner are, in relation to the asset pool—

- (a) to comply with regulation 165; and

- (b) to assign or transfer—

- (i) all interests in the assets in the asset pool; and
- (ii) the benefits and obligations under all contracts relating to the asset pool

to a person other than the issuer-"/owner."

- e) in section 167 (winding up by the court), after subsection (1) insert—

"(1A) But during the protected period an issuer/owner shall carry on its business in relation to the asset pool under the 2007 Regulations until an assignment or transfer is made under regulation 25(7) or the asset pool is ~~wound up~~dealt with under regulation 28."

- f) in section 169 (supplementary powers (Scotland)), after subsection (1) insert—

"(1A) But during the protected period an issuer/owner shall carry on its business in relation to the asset pool under the 2007 Regulations until an assignment or transfer is made under regulation 25(7) or the asset pool is ~~wound up~~dealt with under regulation 28."

- g) in section 239 (preferences (England and Wales)), at the end add—

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"(8) This section shall not apply to any allocation to an asset pool made under regulation 1~~3~~2 of the 2007 Regulations."

h) in section 243 (unfair preferences (Scotland)), after subsection (6) insert—

"(6A) This section shall not apply to any allocation to an asset pool made under regulation 1~~3~~2 of the 2007 Regulations."

i) in section 251 (expressions used generally)—

(i) after the definition of "**administrative receiver**" insert "'**asset pool**' has the meaning given by regulation 2 of the 2007 Regulations;";

(ii) after the definition of "**floating charge**" insert "'**issuer**' has the meaning given by regulation 1(2) of the 2007 Regulations;";

(iii) after "**otherwise requires**" insert "'**2007 Regulations**' means the Recognised Covered Bond Regulations 2007;"; and

(iv) after the definition of "**prescribed**" insert "'**protected period**' has the meaning given by regulation 2~~5~~4(10) of the 2007 Regulations;".

~~52.~~

1) This paragraph applies to ~~an~~a separate owner.

Where ~~an~~a separate owner goes into liquidation Part 4 of the 1986 Act (winding up of companies registered under the Companies Acts) applies with the following modifications—

a) In section 40 (payment of debts out of assets subject to floating charge), after subsection (2) insert—

"(2A) But subsection (2) shall not apply to ~~an~~a separate owner."

in section 107 (distribution of company's property), at the end add—

"(2) But subsection (1) shall not apply to ~~an~~a separate owner."

in section 175 (preferential debts), after subsection (1) insert—

"(1A) But subsection (1) shall not apply to ~~an~~a separate owner."

section 176A (share of assets for unsecured creditors) is to be read as if after subsection (6), there is inserted—

"(6A) But the net property of a company to which the 2007 Regulations apply does not include the asset pool."

in section 251 (expressions used generally), after the definition of "**the official rate**" insert "'**owner**' has the meaning given by regulation 1(2) of the 2007 Regulations;".

Administration

~~53.~~

1) This paragraph applies ~~where the owner is the~~to an issuer/owner.

Where a person is appointed as administrator of an issuer/owner, Schedule B1 to the 1986 Act (administration) applies with the following modifications—

a) In paragraph 3 (purposes of administration)—

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- (i) omit sub-paragraphs (1) to (4) as they apply in relation to the asset pool; and
- (ii) at the end, add—

"(5) The administrator of an issuer/owner must comply with regulation 162 and must perform his functions in relation to the asset pool with the objective of assigning or transferring—

- (a) all interests in the assets in the asset pool; and
 - (b) the benefits and obligations under all contracts relating to the asset pool to a person other than the issuer ~~:"/owner."~~ :"/owner.";
- in paragraph 49 (administrator's proposals)—

- (i) after sub-paragraph (1) insert—

"(1A) The administrator of a company to which the 2007 Regulations apply shall make a separate statement setting out proposals for achieving the purpose of administration at paragraph 3(5).";

- (ii) after sub-paragraph (3) insert—

"(3A) But paragraph (3) shall not apply to any statement of proposals required by sub-paragraph (1A).";

- (iii) after sub-paragraph (4) insert—

"(4A) The administrator of an issuer/owner shall send a copy of the statement of the proposals required by subparagraph (1A) to—

- (a) the registrar of companies;
 - (b) every creditor with a claim over the asset pool of whose claim and address he is aware; and
 - (c) every member of the company of whose address he is aware."; and
- (iv) in sub-paragraph (6), after "(4)(c)" insert "(4A)(c)".

in paragraph 50 (creditors' meeting)—

- (i) in the unnumbered paragraph of sub-paragraph (1), after "**company**" insert "**or a meeting of creditors of the company with claims over the asset pool**"; and
- (ii) in sub-paragraph (1)(b), after "**company**" insert "**or creditors of the company with claims over the asset pool**".

in paragraph 51(1) (requirement for initial creditors meeting), after "**49(4)(b)**" insert "**or 49(4A)(b)**";

in paragraph 52 (requirement for initial creditor's meeting), after sub-paragraph (1) insert—

"(1A) But paragraph (1) shall not apply in relation to a statement of proposals made under paragraph 49(1A).";

in paragraph 59 (general powers), after sub-paragraph (1) insert—

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"(1A) But the administrator of an issuer/[owner](#) must, in relation to the asset pool, exercise the powers in subsection (1) subject to the requirements of regulation 16.";
in paragraph 65 (distribution), at the end add—

"(4) A payment may not be made by way of distribution under this paragraph using assets in the asset pool.";
in paragraph 66 (distribution), at the end add—

"(2) A payment may not be made under this paragraph using assets in the asset pool.";
in paragraph 73 (protection for secured or preferential creditors), after subparagraph (2) insert—

"(2A) But paragraph (2) shall not apply to any statement of proposals required by sub-paragraph 49(1A)."; and
in paragraph 111(1) (interpretation)—

- (i) under "**Schedule**" add ""**2007 Regulations**" means the Recognised Covered Bond Regulations 2007;"
- (ii) after the definition of "**administrator**" add ""**asset pool**" has the meaning given by regulation (1) of the 2007 Regulations;" and after the definition of "**in administration**" insert ""**issuer**" has the meaning given by regulation 1(1) of the 2007 Regulations;"

**JOINT MEMORANDUM OF
CLIFFORD CHANCE LLP, ALLEN & OVERY
and LINKLATERS LLP**

**Joint industry group response to proposed Recognised Covered Bond Regulations
Explanatory Memorandum to Joint Mark-Up of Regulations**

This memorandum accompanies the response of the joint industry group consisting of BBA, LIBA, CML and ICMA to the proposal to establish a UK Recognised Covered Bond regime.

Clifford Chance LLP, Allen & Overy and Linklaters LLP have been working alongside the Multilateral Forum in connection with their response.

This memorandum provides an explanation to the material changes to the Recognised Covered Bond Regulations which the above firms have suggested in the mark-up of the Regulations enclosed with the above response. The mark up contains detailed drafting changes to reflect our concerns on many issues in the Regulations and to reflect the views of the joint industry group.

We have not focussed on the insolvency issues in relation to the integrated structure and mainly on issues in relation to the segregated structure because it is the view of the joint industry group that it is unlikely that the integrated structure will be used and there is doubt that it can be made to work successfully from an insolvency perspective in the timeframe set for the implementation of the regime.

References to numbered Regulations in this Memorandum are to the original numbering in the Regulations although we have indicated the new numbering appearing in the WORD mark-up we have provided.

1. **Seller of assets other than issuer:** The Regulations do not deal (in relation to the segregated structure) with the situation where the seller of all or part of the asset pool to the owner is not also the issuer. This occurs in the existing HBOS structure, and a number of the other structures (e.g. Abbey and Northern Rock) provide for new sellers to sell assets into the cover pool where those sellers are not also the issuer. Banks want this flexibility in case a subsidiary or other group entity originates eligible assets that it wants to put into the cover pool. Of course, a seller which is not the issuer may not be a credit institution. For this purpose, we have provided in the mark-up for a definition of "**asset transferor**" which can be the issuer or another person who transfers an asset pool to a separate owner.
2. **Distinction between "issuer/owner" and "separate owner":** There is much possibility of confusion in the Regulations in distinguishing between an owner which is also the issuer and an owner in a segregated structure which is not the issuer. It would be much clearer if distinctive terminology could be used for each such entity. We have provided this in the mark-up where we have used the terms "**issuer/owner**" in relation to the integrated structure and "**separate owner**" in relation to the segregated structure where the owner is not the issuer. In the mark-up we have also made that distinction clear in the definition of "**covered bond**".

3. Definition of "**insolvency**". This has been added because both an issuer or owner may be incorporated in any of the individual jurisdictions of the United Kingdom and it is necessary for the purposes of various provisions in the Regulations to distinguish between these jurisdictions.

Also, "Insolvency" as previously defined by reference to s. 247(1) Insolvency Act 1986 included voluntary arrangements and receiverships within the definition. This contradicted Regulation 20 with regard to an issuer/owner. The capability test in Regulation 13(2) (now 12(2)) should not be disapplied by Regulation 13(3) (now 12(3)) but should still apply in the event of the appointment of a receiver or administrative receiver, whether of an owner or issuer/owner. In Regulation 16(a) (now 15(a)), reimbursement upon the separate owner's insolvency should not be triggered by a voluntary arrangement or the appointment of a receiver or administrative receiver. As an issuer may include a UK branch of a non-UK credit institution, the definition has also been extended to include a reference to analogous procedures under the law applicable to the winding-up of the issuer (the law of the jurisdiction of incorporation of the non-UK credit institution).

4. Definition of "**register of recognised covered bond programmes**". This has been added as the Authority should keep a register of each recognised covered bond programme as well as issuers and issues because an issuer may have more than one programme and it will be important to ensure that such programme is also approved and recognised.
5. Reg. 2 (f) - this paragraph has been added to deal with assets allocated or transferred to the asset pool as part of the over-collateralisation of the asset pool. See mark-up attached.
6. Reg. 2 (g) - this paragraph has been added to deal with the contractual rights which an owner acquires as part of the asset pool and which will also need to be transferred if a new separate owner is established.
7. Reg. 3 (1) - see mark-up attached. The words "an interest in" are intended to cover the fact that a beneficial interest only in the relevant assets may be transferred (rather than the legal and beneficial interest).
8. Reg. 3 (2) - the amendments to this regulation have been made so as to conform the definition of the situation of the eligible property with that in the response provided by the joint industry group .
9. Reg. 6 (2) - the amendments to this regulation have been made so as to conform the definition of who may be an issuer with that proposed by the joint industry group . The mark-up reflects the view that an issuer in the integrated structure may only be a UK incorporated "credit institution" as any amendments to UK insolvency law enacted to give effect to the segregation of the asset pool on the issuer/owner's insolvency will not be applied in winding-up proceedings of an EEA credit institution under Article 10 of the Winding-Up of Credit Institutions Directive. However, for the segregated structure it can be an EEA branch of a credit institution incorporated elsewhere as UK insolvency rules need not apply to it as issuer.

10. Reg. 6 (5) - the grounds of refusal for recognition should not be that it would be detrimental to the interests of investors in covered bonds generally, but that it would be detrimental to the interests of investors in the actual proposed covered bonds - see mark-up.
11. Reg. 7 (4) - these provisions have been added to provide guidance to the authority as to how it should discharge its functions under the Regulations given that FSMA does not technically apply to the Regulations.
12. Reg. 8 (1) – the view of the joint industry group is that six months for considering an application for recognition is too long and this should be 3 months, but are proposing that this can be dealt with by way of an FSA service standard. As a result we see the six months as a backstop and have therefore removed the provision to extend the period for an additional month, where a request for additional information is made.
13. Reg. 9 - as this deal with a specific issue of a voluntary change of owner in the segregated structure, we have moved this to Part 5 dealing with the owner of the asset pool and it is now Regulation 17. This regulation can apply in the case of both an issuer/owner and a separate owner as an issuer/owner if it were in difficulties may decide to transfer the asset pool to a separate pool to protect the interests of the covered bond holders.
14. Reg 13 (now 12)- it is here, in particular, that the Regulations need to make reference to the possibility that the asset pool may be transferred to a separate owner by a person other than the issuer, as mentioned in item 2 above. The mark-up also deals with the actual mechanics of what is done with the issuer proceeds in both an integrated and segregated structure. Our mark-up does not contemplate the situation where a seller not being the issuer could transfer an asset pool to an issuer/owner who would then allocate that eligible property to the asset pool. We think this is an unlikely scenario.
15. Reg 15 (now 14) - Part 4, we have revised this part significantly so it now only deals with the situation where there is a separate owner. In relation to a separate owner we have clarified that it needs to have its registered office and its "centre of main interests" in the UK.
16. Reg 16 (now 15) - we have deleted many of the provisions previously here as being inapplicable to a separate owner who cannot agree to maintain the asset pool or ensure any matters in relation to the status of the asset pool or whether it is capable of covering the claims attached to the bonds. Only the issuer can do this as these matters are solely within the issuer's capacity.
17. Reg 20 (now 21) - although the integrated structure is really outside the scope of this memo, it is not clear how the transfer of the asset pool to a new owner will protect the interests of the covered bondholders. Does the new owner have to guarantee the performance of the obligations of the issuer as if the covered bond issue were to become a segregated issue or is the asset pool intended somehow to be available to the covered bond holders post default of the issuer. As after such transfer, the owner will be a person other than the issuer, is it intended, for example, that Reg 26 should apply so that the legal title to the asset pool is transferred to such new owner? The purchase price for the

transfer also needs to be considered for any such transfer (see our comments on Regulation 25(7) below. Sections 238 and 239 (and their Scottish equivalents) need to be disapplied in relation to any such transfer.

18. Reg 21 (now 20) - Change of Owner - we have made it clear that this only applies to a separate owner. We have deleted Reg 21 (2), as it is not now necessary given the split of definition of owner into issuer/owner and separate owner.
19. Reg 23(4), 24(4) and 25(8) – as an administrator or liquidator of the pool is not able to top it up, it seems onerous to make them subject to Regulation 13. They should merely be required to notify the Authority if the asset pool no longer complies with the requirements of Regulation 13.
20. Regulation 25(7) – this needs to set out the purchase price for the assignment or transfer to the new separate owner. An SPV owner will not be able to pay any purchase price other than the excess assets in the asset pool after the claims of covered bondholders and other relevant entities have been satisfied. The reference to “all other creditors in respect of the asset pool” is intended to cover the HSBC structure – i.e. where the other creditor is the “RMBS Member” for its share of the asset pool.
21. Reg 26 - where the issuer is not the owner and the owner has had the asset pool transferred to it by the relevant sellers (whether the issuer or other persons), such a transfer would have been in equity only and the seller would have retained the legal title (see our comment on Regulation 3(1) above). On the insolvency of the issuer, the owner would have been able through the security power of attorney granted by the relevant seller to the owner, to have transferred to it the legal title in the assets. It does not require the liquidator to effect such a transfer. In fact, it is probably the case that the liquidator will have no power to do so as the issuer would only be holding the bare legal title on trust for the owner and can effect no dealing with it. Accordingly, we have amended this regulation to merely provide that the liquidator shall assist in any such transfer.
22. Reg 27 - we do not understand the purpose of this Regulation. Firstly it can only apply to a separate owner as an issuer/owner will not need to create any security interest over the asset pool as the effect of the Regulations is to separate such pool from the insolvency estate of the issuer/owner in the event of its insolvency.

A separate owner, in line with current structured covered bonds, will create security over all of its assets in favour of the trustee for the recognised covered bond holders and other service providers and the swap counterparties. However, such security will not become enforceable until there is a default by the separate owner under its guarantee obligations in respect of the recognised covered bonds.

If a receiver is appointed in respect of the separate owner after its security has become enforceable, prior to the separate owner being wound up, it is very unlikely that the receiver would "go into possession" of such property as Regulation 27(2) suggests and even if the receiver recovers sums derived from the security over the separate owner's property it will be applied against the obligations of the separate owner as guarantor under its guarantee.

If this Regulation is trying to say that if the eligible property is subject to a charge in favour of persons other than those entitled under the recognised covered bonds then it must be applied first in payment of the "priority claims" set out in Regulation 27, then it is not very clear and our mark-up tries to clarify this.

23. We have also included language in new Regulation 28(1)(c) to cover a situation where a lender agrees to provide liquidity support to the issuer/owner [or separate owner] both before and after the issuer/owner's [or separate owner's] insolvency. This will be important to the rating agencies as they rely on the ability of the issuer/owner [or separate owner] to access additional funds where required. Any such liquidity provider will only agree to provide that support if ranks ahead of the claims of the covered bondholders.
24. We have deleted Regulation 28(2). This is because:
- (a) In our joint view, the purpose of Article 22(4) of the UCITS Directive is satisfied solely by the requirement for the claims of the persons referred to in Regulation 28(1) to be paid *in priority to all other creditors*.
 - (b) It is not right to make the claims of all creditors on the asset pool rank *pari passu*. In particular, it would be normal, and indeed required by the rating agencies, for the claims of certain creditors in the covered bond deals to be *subordinated* to the claims of the covered bondholders (e.g. certain termination payments due to swap counterparties and the claims of some of the service providers and the claims of the issuer in respect of its intercompany loan to a separate issuer). In addition, the claims of some creditors should be paid in priority to the claims of the covered bondholders (e.g. any liquidity provider, the bond trustee and the paying agents). Accordingly, in the existing covered bond deals all the relevant secured creditors agree to rank their claims according to a set order of priority and to protect that subordination through a turn-over trust. Any such agreement in relation to priority between the secured creditors is binding on administrator or liquidator of the separate owner – see *In Re Maxwell Communications Corporation plc* (No. 2) [1994] 1 All ER 737 and *Squires and others v. AIG Europe (UK) Ltd* [2006] EWCA Civ 7.
 - (c) Relying on the ability of a liquidator to incur certain expenses as part of the cost of winding up will not work unless that is expressly provided for – otherwise your proposed wording in Regulation 28(2) would override that discretion.
25. Regulation 28(4) can be deleted if the purchase price is expressly dealt with in Regulation 27(5).
26. In Schedule 1 the references to the administration regime are those in place prior to the changes made to the Insolvency Act 1986 by the Enterprise Act and need to be updated. The relevant provisions are now in Schedule B1 IA 1986.
27. In Schedule 1, regulation 50 (2)(g), now 51(2)(g), reference should also be made to the disapplication of section 239 to transfers under regulation 24(2) now [25(7)].

Linklaters LLP

17 October 2007

PROPOSALS FOR A UK RECOGNISED COVERED BOND LEGISLATIVE FRAMEWORK

Extracts from Annex D (Recognised Covered Bond Specialist Sourcebook Instrument 2007) ¹

2. Applications for recognition

Application

2.1 G This chapter applies to *issuers*.

Purpose

2.2 G This chapter sets out the requirements that an *issuer* must follow to apply for recognition as a *recognised covered bond issuer* and for recognition of a recognised covered bond programme and a recognised covered bond under Regulations 6 of the *RCB Regulations*.

Form and manner of application

2.3.1 D The *issuer* must use the *FSA's* form.

2.3.2 D The *issuer* must send the form electronically to the address stated on the form.

2.3.3 D The *issuer* must send the recognition fee with the application (see 6.5R). The *FSA* will only treat the application as complete when it receives the fee.

Determination of recognition

2.4.1 G To enable the *FSA* to be satisfied that the *issuer* and *owner* will comply with requirements imposed on the *issuer* or *owner* as the case may be by or under the *RCB Regulations*, the applicant must use the application form to provide relevant details of the covered bond issue or covered bond programme and demonstrate how each of the requirements will be complied with.

2.4.2 G The FSA expects the issuer to apply for recognition of a covered bond programme at the same time and on the same form as they apply for recognition to be a recognised covered bond issuer. But, once an issuer and the covered bond programme has been admitted to the register of issuers it will only need to apply for recognition of the particular covered bond. The issuer may apply for recognition of the initial series of covered bonds to be issued under a covered bond programme at the same time as it applies for recognition of a covered bond programme.

2.4.3 G In relation to recognition as an *issuer* the *FSA* will need to be satisfied that the *issuer's* compliance with the requirements of the *regulatory system* has been adequate and does not give rise to any material cause for concern over the *issuer's* ability to issue recognised covered bonds in compliance with the *RCB Regulations*.

2.4.4 G To demonstrate that the *issuer* and *owner* will comply with Regulation 13(2) and Regulation 16(a) of the *RCB Regulations* (obligation to ensure the asset pool is, during the period of validity of the bond, capable of covering claims attaching to the bond), the *issuer* should set out the risks it has considered to the regulation not being complied with and show how those risks have been adequately mitigated.

2.4.5 G The *FSA* expects the *issuer* to demonstrate that there are provisions in the covered bond programme that adequately deal with:

(1) the identification and rectification of any breach of Regulations 13(2) and 16(a) of the *RCB Regulations*, and

(2) In the case of an issuer/owner, the orderly winding up of the asset pool in the event that the [timely] rectification of breaches of Regulations 13(2) and 16(a) does not occur

(3) In the case of a separate owner, the terms of the guarantee of the issuer's obligations.

2.4.6 G The *FSA* expects the *issuer* to demonstrate, as part of showing that Regulation ~~16-12(a2)~~ will be complied with, that there are provisions in the covered bond programme which (i) enable meetings of investors in recognised covered bonds to be convened at which their views can be heard in relation to the nature of the business to be transacted at the meeting and (ii) provide for

¹ We have included the full text of the relevant rules to set the requirements in context. The references to third party verifications have been highlighted in bold.

Annexe 2

the appointment of an independent, suitably qualified third party to represent the investors in recognised covered bonds ~~the views and interests of investors in the recognised covered bond to be taken account of in an appropriate and timely way by a suitable qualified, adequately resourced~~ [Comment: "appropriate", "timely" and "adequately resourced" are all subjective terms and it is not clear how compliance could therefore be tested. In the existing programmes, bondholders are represented by the covered bonds trustee. The terms and conditions of the covered bond set out the circumstances when the covered bonds bond trustee will be obliged to seek the views of covered bondholders – generally this will occur when a material amendment is to be made to the documents. The terms and conditions also specify when bondholders may requisition the convening of a meeting – which is generally when they wish to accelerate the bonds or declare an event of default, subject to the terms of the documents. It would be helpful if these guidelines could specifically refer to a bond trustee. It would also be helpful to understand what you mean by "third party", as the covered bonds trustee would be connected with the programme by virtue of being a secured party entitled to fees etc. ~~1. independent third party.~~

- 2.4.7 G The FSA expects the *issuer*, for the purposes of demonstrating compliance with Regulations 2 and 3 (compositions and situation of *asset pool*), to give details of the types of *assets* in the *asset pool* and the location ~~situation~~ of those *assets*.

Verification of information²

- 2.5 D Senior management of the *issuer* ~~and a suitable qualified independent third party professional advisor~~, must verify the application by confirming on the FSAs form that they are satisfied that:
- (1) the information provided in the application is correct and complete,
 - (2) the arrangements relating to the bond programme will comply with the requirements in the RCB Regulations and this sourcebook.

- 2.6 Legal advisors to the issuer shall complete the checklist in the form provided to confirm relevant details of the bond issue or programme.

- 2.7 D Senior management of the issuer shall confirm to the FSA that on or prior to the date of the first issue of covered bonds under the programme, it will have evidence available in its records that independent accountants have performed certain procedures concerning the accuracy of:

i) those attributes of the (proposed) asset pool (or a sample thereof) on which senior management based their assessment of the capability of the asset pool under Regulation 13(2) of the RCB Regulations.

ii) the over collateralisation tests on which senior management based their assessment of the capability of the asset pool under Regulation 13(2) of the RCB Regulations.

- 2.8. D Senior management of the issuer shall confirm to the FSA that on or prior to the date of the first issue of covered bonds under the programme, it will have evidence available in its records that its legal advisors are satisfied, subject to the usual qualifications, that:

(1) where the issuer is not the owner, no liquidator, administrator or other creditor of the issuer would be able to contest successfully the transfer of the relevant assets from the issuer to the separate owner; and

(2) where the issuer is not the owner, the separate owner's guarantee of the obligations of the issuer in respect of the recognised covered bonds is a legal, valid, binding and enforceable obligation including following the administration or liquidation of the issuer.

- ~~(i) D Legal advisors to the issuer shall complete the checklist in the form provided to confirm relevant details of the bond issue or programme.~~

- ~~(ii) 2.7 D [Accountants to the issuer shall provide to the issuer copied to the FSA [insert information to be provided – see PwC report]~~

- ~~(iii) 2.8. D Senior management of the issuer shall confirm to the FSA that on or prior to the date of the first issue of covered bonds under the programme, it will have evidence available in its records that its legal advisors are satisfied, subject to the usual qualifications, that:~~

² See the attached Application Form, taken from Annex C.

Annexe 2

(iv) ~~(1) where the issuer is not the owner, no liquidator, administrator or other creditor of the issuer would be able to contest successfully the transfer of the relevant assets from the issuer to the owner; and~~

~~(2) where the issuer is not the owner, the owner's guarantee of the obligations of the issuer in respect of the recognised covered bonds is a legal, valid, binding and enforceable obligation including following the administration or liquidation of the issuer.~~

3. Notifications

Application

3.1 G This chapter applies to *issuers, owners, administrators, provisional liquidators, and liquidators.*

Purpose

3.2 G This chapter sets out the reporting and notifications requirements under Regulations 14, 17-19, 23, 24 and 25 of the *RCB Regulations*.

Manner, timing and verification of notifications by *issuer* under Regulation 13 of the *RCB Regulations*.

3.3 D The issuer must send to the *FSA* written confirmation of compliance with Regulation 13(1) (transfer and allocation of sums to asset pool) and Regulation 13(2) (ensuring asset pool capable of covering claims) of the *RCB Regulations*.

Timing of confirmation

3.4.1 D The first confirmation date is the earlier of, any date the *issuer* selects, or the date 12 months from the *recognition date*. The *issuer* must make subsequent confirmations on the anniversary of the first confirmation date.

3.4.2 D The *issuer* must send the confirmation to the *FSA* within 1 month after the relevant confirmation date.

Period covered by confirmation

3.5.1 D The first confirmation must cover compliance during the period from the *recognition date* up to the confirmation date referred to in 3.4.1.D above. *[Comment: the one month grace period in 3.4.2(D) will have to be used, because the cut-off date for the information is the same as the confirmation date – the issuer and accountants will need time to do the verification.]*

3.5.2 D Subsequent confirmations must cover compliance for the duration of the period from the last confirmation to the date of the current confirmation.

Verification of confirmation

3.6.1 D *Senior management* of the *issuer* must verify confirmation of compliance with Regulation 13(1).

3.6.2 D ~~Both *Senior management* of the *issuer*, and a suitably qualified independent third party professional advisor~~ must verify compliance with Regulation 13(2).

3.6.3 D Senior management of the issuer shall confirm to the FSA that it has evidence available in its records that accountants to the Issuer have performed certain procedures, at a date not more than one month prior to the confirmation date, concerning the accuracy of:
i) those attributes of the asset pool (or a sample thereof) on which senior management based their assessment of the capability of the asset pool under Regulation 12(2) of the RCB Regulations.
ii) the over collateralisation and other tests on which senior management based their assessment of the capability of the asset pool under Regulation 12(2) of the RCB Regulations.

(v) ~~[Accountants to the issuer shall provide to the issuer copied to the FSA [insert information to be provided].]~~

Manner, timing and verification of notifications by the *owner* under Regulation 17 of the *RCB Regulations*

[We are not sure how a separate owner makes arrangements for the maintenance and administration of the asset pool so that the asset pool will meet the capability requirement (the 13 (2) requirement). If it simply requires confirmation that the separate owner has entered into a servicing agreement that requires the servicer to undertake reasonable efforts to ensure that the capability requirement will be met, then that is a matter for confirmation in the checklist below.]

Annexe 2

~~1.2 — 3.7.1 D — The owner must make arrangements to ensure that the FSA receives written confirmation of compliance with Regulations 13(2) and 16 of the RCB Regulations (requirements relating to the asset pool).~~

~~1.3 — 3.7.2 D — The owner must send or ensure that the issuer sends the confirmation to the FSA annually and at the same time as the date confirmations under 3.5 D are due. The confirmation must cover the same period as under 3.5 D above.~~

~~1.4 — 3.7.3 D — Where the owner is a person other than the issuer, and the issuer has gone into insolvency (as defined in Regulation 1 of the RCB Regulations), the owner must send a confirmation of compliance to the FSA within 1 month from that date. The owner must in addition continue to send annual confirmations under 3.7.2 D. [As owner will at this stage be managed by independent members/directors at this stage, will such members/directors be able to take on this liability? They would want to be indemnified out of assets of LLP unless they have acted fraudulently.]~~

~~1.5 — 3.7.4 D — Senior management of the issuer must verify the confirmation. [Accountants to the issuer shall provide to the issuer copied to the FSA [insert information to be provided — see PwC report].~~

~~1.6 — A suitably qualified independent third party professional advisor must, in addition, verify compliance with Regulation 16 (a).~~

~~3.7.5 D — But, confirmation of compliance with Regulation~~

~~16 (a)~~

~~1.7 — 13(2) will not be required if the issuer has, in respect of the same period, sent written confirmation of compliance with Regulation 13 (under 3.3 to 3.5 D above).~~

1.8

Change of owner

3.8.1 D Where an owner proposes to transfer the asset pool to new owner pursuant to Regulation 9 of the RCB Regulations he must provide the following information in writing to the FSA at least 3 months before the proposed transfer date:

- (1) Name, address and contact details of the new owner
- (2) Reasons for the transfer
- (3) An explanation of how the new owner will comply with the requirements imposed on it by the RCB Regulations
- (4) The terms of any guarantee provided by the new owner.
- (5) The principal terms of any servicing arrangement entered into by the new separate owner in relation to the maintenance of the asset pool.

[If the issuer is the owner then doesn't Reg 9 have to deal with a change of issuer also (i.e. that new issuer has taken on obligations under covered bonds) or is this suggesting that a transaction can move from an integrated type to a segregated type which would be very odd? Need to consider terms of Reg 9.]

~~3.8.2 D — [On a date which is not more than [4] weeks prior to the proposed transfer date (the cut off date), [Accountants to the issuer shall provide to the issuer copied to the FSA [insert information to be provided — see PwC report].~~

3.8.2 D Senior management of the issuer shall confirm to the FSA that it has evidence available in its records that accountants to the Issuer have performed certain procedures, at a date not more than one month prior to the proposed transfer date, concerning the accuracy of :

- i) those attributes of the asset pool (or a sample thereof) on which senior management based their assessment of the capability of the asset pool under Regulation 12(2) of the RCB Regulations.
- ii) the over collateralisation and other tests on which senior management based their assessment of the capability of the asset pool under Regulation 12(2) of the RCB Regulations.

~~Senior management of the issuer shall confirm to the FSA that on or prior to the proposed transfer date, it will have evidence available in its records that its legal advisors are satisfied as at the proposed transfer date, subject to the usual qualifications, that:~~

Annexe 2

- ~~(1) no liquidator, administrator or other creditor of the owner would be able to contest successfully the transfer of the relevant assets from the owner to the new owner; and~~
~~(2) the new owner's guarantee of the obligations of the issuer in respect of the recognised covered bonds is a legal, valid, binding and enforceable obligation including following the administration or liquidation of the issuer.~~

~~A suitably qualified independent third party professional advisor must confirm in writing that they are satisfied that the information provided is complete and correct.~~

- 3.8.3 D Where Regulation 20 of the *RCB Regulations* (obligation to transfer when issuer fails to meet adequacy of resources requirements) applies, the owner must provide the information required in 3.8.1 D immediately.

Notifications to the FSA under Regulations 18 and 19 of the *RCB Regulations* (assets not capable or not likely to be capable of covering claims)

- 3.9.1 G The FSA expects ~~owners a separate owner or other persons~~ [to notify it immediately in writing if, following the insolvency of the issuer, the assets in the asset pool will not be sufficient to reimburse principal and interest on the recognised covered bonds.
~~The owner or the issuer or other person should include details of proposals to rectify the breach when they notify, or as soon as practicable after that time.~~

Manner, timing, and verification of notifications by the administrator, provisional liquidator and liquidator.

- 3.10.1 D [The administrator, provisional liquidator or liquidator must confirm compliance with Regulation 16 within 2 weeks of their appointment and after that annually from the date of appointment.] [Comment: We are not sure how administrator makes arrangements for the maintenance and administration of the asset pool so that the asset pool will meet the capability requirement (the 13(2) requirement). If it simply requires confirmation that the owner has entered into a servicing agreement that requires the servicer to undertake reasonable efforts to ensure that the capability requirement will be met, then this should be added to the checklist items referred to below.] They must send the confirmation to the FSA within 1 month of the relevant confirmation date.

~~The administrator, provisional liquidator or liquidator must confirm compliance with Regulation 16 within 2 weeks of their appointment and after that annually from the date of appointment. They must send the confirmation to the FSA within 1 month of the relevant confirmation date.~~

- ~~3.10.2 D Confirmations must cover compliance for the period from the last confirmation to the date of the current confirmation.~~

- ~~3.10.3 D [Accountants to the issuer shall provide to the issuer copied to the FSA [insert information to be provided see PwC report] A suitably qualified independent third party professional advisor must verify the confirmation of compliance with Regulation 16(a) of the RCB Regulations.~~

- ~~3.10.4 G The directions in 3.10 D apply where the issuer and the owner are the same person/~~

- ~~3.11. R [If an issuer, owner, provisional liquidator or administrator] [see comment above] does not provide a notification to the FSA of the sort required by directions 3.3, 3.4.2, 3.7.1, 3.7.2, 3.8 or 3.11.1 by the date required, then the issuer, owner, provisional liquidator, liquidator or administrator must pay to the FSA an administrative fee of £250.] [See comment above]~~

Annexe 2

CHECK LIST ITEMS

List the documentation prepared for the Covered Bond programme.

Identify the provisions relating to the requirements set out in Regulation 13(2)

Identify the provisions relating to the requirements set out in Regulation 16(a).

Identify the provisions relating to the types of assets that can go into the asset pool.

Identify the provisions relating to the location of the assets.

Where the issuer is not the owner, identify the provisions relating to effect of (i) the insolvency of the issuer and [(ii) the insolvency of the owner.]

Identify the provisions which relate to the convening of meetings of investors in recognised covered bonds.