Building Societies Association

York House
23 Kingsway
London
WC2B 6UJ

Telephone: 020 7520 5900
Fax: 020 7240 5290
www.bsa.org.uk

BANK OF ENGLAND / ECB DP ON SECURITISATION

RESPONSE FROM THE BUILDING SOCIETIES ASSOCIATION

Introduction

The Building Societies Association (BSA) represents mutual lenders and deposit takers in the UK including all 44 UK building societies. Building societies have total assets of nearly £330 billion and, together with their subsidiaries, hold residential mortgages of over £230 billion, 18% of the total outstanding in the UK. They hold over £230 billion of retail deposits, accounting for 19% of all such deposits in the UK.

The BSA welcomes the joint initiative by the Bank and the ECB, begun with the brief paper published on 11th April and developed in the end-May Discussion Paper (DP), to "make the case" for a better functioning securitisation market in the EU.

In this high-level response we concentrate on matters relevant to our members' experience, and potential future activity, as originators and occasional investors. We agree with the broad summary of the benefits of securitisation in section 2, and it is helpful to have these officially re-stated.

General comments

The core business of all BSA members lies within traditional relationship banking: personal savings and mortgage lending. BSA members are not investment banks and do not structure complex transactions for others. Moreover, building societies are obliged by law to concentrate on retail savings and residential mortgages. Consistent with the relationship approach, BSA members primarily follow the "originate to hold" rather than "originate to distribute" model. We fully recognize the problems that have arisen during the financial crisis from unwise and irresponsible use of securitisation by others. But some of our largest members continue to make prudent and measured use of securitisation as originators, for risk transfer and capital relief, and /or for longer-term matched funding, and some may also invest in RMBS from time to time. The BSA therefore has an interest in maintaining an active, liquid and cost-effective market for securitisation.

Our first concern, consistent with our members' prudent use of securitisation, is that the technique should not continue to be broadly stigmatized, *inter alia* through onerous capital treatment, by way of over-reaction to the admittedly unwise activities by other players before the financial crisis. Where undesirable behaviours are identified, regulation should target these more closely, without overall stigmatisation of securitisation as a financing technique.

We therefore welcome the recognition in the April paper and the following DP that some of the obstacles to securitisation are regulatory in origin, indeed that some of the post-crisis proposals may have been counterproductive. And we generally support the concept of "qualifying securitisations" for the labelling of those *transactions* that are simple, structurally robust and transparent. We agree – as proposed in the DP – that such labelling should in principle cover the whole transaction – all tranches – and not be limited to the most senior tranche only.

We note that the industry had already taken steps towards setting quality standards through the establishment of the Prime Collateralised Securities initiative and label in 2012. The PCS initiative and label, suitably developed and regulated, could perhaps form the basis for certifying "qualifying securitisations" – so avoiding duplication and confusion, and (it is hoped) minimising costs to the industry.

A particular concern for our medium-sized and smaller members is that the qualifying securitisation criteria should not discriminate against multi-originator pooled RMBS issues. Single-originator issues may not be economical for those societies, as each may have insufficient assets available to justify a solo issue bearing in mind the upfront costs and other fixed overheads. Discrimination against pooled issuance would be anti-competitive, favouring large incumbent firms.

Specific responses

We broadly agree with the summary of the benefits of securitisation in section 2 of the DP. For BSA members, the principal benefits will be as a funding tool and in some cases also as a risk transfer mechanism bringing capital relief.

We agree that paragraphs 63 to 95 cover the key impediments from an issuer / originator perspective. The greatest impediments to those BSA members that have **not** so far used securitisation are probably *asset availability* (paragraph 85); and *systems and credibility* (paragraph 88). We also identify, as a composite impediment, the question of *scale* and the extra complexity of multi-originator RMBS mentioned above. Many medium-sized building societies generate sufficient suitable mortgage assets to contribute to a pooled RMBS involving, say, five originating societies which spreads the fixed costs over a sufficiently large total pool to make the transaction economic, where none of the participating societies could economically undertake a solo transaction as their available asset pool is too small.

The *regulatory impediment* operates both directly and indirectly. Some of the proposals in the Basel securitisation review were, as the DP politely admits, "unduly conservative", and will have had a direct effect in discouraging securitisation e.g. by making transactions uneconomic from the capital relief perspective. The indirect regulatory effects include the current uncertainty, pending finalisation and implementation in the EU of whatever results from the Basel review, and (more generally) the hostile and stigmatising rhetoric that has sometimes accompanied these regulatory proposals. We doubt, in the absence of more favourable regulatory treatment for qualifying securitisations, whether such labelling on its own will achieve the desired step change towards a better functioning securitisation market. The case for more favourable treatment is supported by the conclusions of the empirical study[1] by Perraudin / Risk Control Ltd, commissioned by the PCS.

Two lesser impediments fall under the heading of design of ancillary facilities, as mentioned in the DP at paragraphs 118- 123. First, the penal swap counterparty criteria introduced by the ratings agencies post-crisis, and the requirement for "volatility buffers" (effectively collateral add-ons). Second, the problem of SPV bank accounts, and whether these could be made insolvency remote – we think this would be (net) beneficial, though difficult to achieve without, for instance, some central bank involvement.

Turning to the high level principles, these appear broadly sensible. We have two specific comments relevant to our members' potential future issuance of RMBS. First, we query the

[1] http://pcsmarket.org/wp-content/uploads/2014/06/empirical-study-of-high-quality-securitisation.pdf

practical impact of the criterion on ***perfection of interest***. As stated, this appears to require the perfection of the issuer's title to each mortgage by registration of the transfer from the seller with notice to the underlying borrowers. We understand this has not been customary in UK RMBS, rather the initial sale takes effect in English law as an equitable transfer, and the issuer has the ability to effect registration at any time, thereby perfecting its legal title, without further involving the seller at that stage. A move to full registered legal transfer at the point of original sale would be a major departure from current practice (which has not proved problematic in the UK and arguably does not need to be changed).

Second, we suggest that - for the avoidance of doubt – the principles should include an explicit statement to the effect that multi-originator securitisations may qualify, notwithstanding the slight increase in structural complexity.

Those of our members with extensive securitisation experience may wish to respond in more detail to the technical questions in the DP.

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