

Finalised guidance

Thematic Overview: Regulated Covered Bond Regime



March 2012

Dear Sir,

After publishing guidance on the role of the compliance function in November 2011, we decided to issue further guidance on additional areas of the RCB regime to set out our minimum expectations, which we outline here. These areas cover the scope and depth of engagement with the programme by the person who signs the annual confirmation of compliance (RCB 3 Annex 1D); the content of Management Information; and the appropriateness of systems and controls.

We believe that this will contribute to promote transparency and investor understanding of the UK's regulated covered bond (RCB) regime, which we supervise.

We consulted on this guidance for a six-week period to seek views from market participants on its content and potential resulting incremental costs. This guidance reflects the feedback received.

FSA expectations

In relation to the production and content of **Management Information (MI)** of all regulated programmes, we expect that as a minimum:

- MI should include clearly defined responsibilities and processes for extracting data, sense checking (including trend analysis/anomalies) and sign off before use;
- MI should include regular reporting of current risks and performance indicators including trend analysis and risk indicators;
- reporting frequency should be at least in line with key committee meetings;
- the content, quality, and accuracy of MI should be sufficient to support appropriate level of discussion and decision making;
- reporting should incorporate predictive/stressed pool performance, forward looking analysis of key tests/risks, information on eligible unencumbered assets, potential/actual breaches, short term liquidity management, hedging positions (incl. values and related risks) entered by the Limited Liability Partnership with swap counterparties;

- issuers should be able to articulate how this MI is monitored and prove how it is used to support or challenge decision making; and
- issuers should be able to articulate monitoring of risk and escalation mechanisms outside of regular committee meetings.

We expect issuers to be able to prove the **systems and controls environment** for regulated programmes includes the following as a minimum:

- clear identification and monitoring of operational risks;
- clearly defined roles and responsibilities for business areas involved in the management of regulated programmes, including the identification of ‘key man’ risks and mitigating strategies;
- clear process for posting collateral for swaps, contingency arrangements and sensitivity of RCB rating to key drivers;
- defined controls with clearly designated roles and responsibilities for producing data files, calculating contractual tests, reviewing inputs/outputs and escalating breaches;
- limited level of manual processes embedded in the management of the programme with identification of any corresponding operational risks and appropriate mitigation;
- relevant IT infrastructure is adequate to support programme management and facilitate clear audit trail, including the production of accurate reporting data and information, and the management of cover pool programme cash flows on a timely basis;
- models used are adequate to capture risks and processes. Model validation, controls and stress testing fit for purpose, taking into account risks specific to the issuer. Model output to form an effective part of MI;
- key people have a clear understanding of limits on issuance and relevant factors (e.g. risk appetite, asset encumbrance, origination strategy); and
- key people have a clear understanding of how retail/origination strategy generates available/eligible collateral for regulated programmes. Issuers should be able to articulate monitoring and management of risks arising from business strategy/implementation.

We expect that the **senior manager who signs the annual confirmation of compliance** for all regulated programmes should as a minimum:

- have a clear understanding of key risks and issues (incl. current triggers/breaches/outstanding RCB issues) and mitigating actions;
- understand the key regulatory responsibilities and requirements relating to the programme; articulate where authority/oversight has been delegated and escalation mechanisms; and be able to take action on escalated matters on a timely basis;
- be able to clearly articulate issuance plans, overall funding strategy (Asset Liability Management mismatch, etc) and operational capacity to issue and have the ability to challenge decisions related to the management of the programme;

- demonstrate a clear understanding of constraints on issuance (asset encumbrance, market issues). In addition, they should be able to outline how these are monitored and where/how strategic decisions on issuance are taken;
- demonstrate a clear understanding of the market view of RCB, depth and concentration of investors (region, type) and associated risks. Able to articulate investor feedback relating to RCB programme/UK market;
- act as the person ultimately responsible for signing the annual attestation of compliance of the programme; and
- have an appropriate level of interaction with the Compliance function and other key functions before signing off the annual attestation.