

UK regulated covered bonds

The FCA's supervision of UK regulated covered bonds: Maintaining confidence in the UK regulated covered bond sector

In this factsheet, we explain our role in supervising regulated covered bond programmes and regulated covered bonds, highlight key features of the regime and provide an overview of the FCA's stress testing of these programmes.

Regulated covered bonds (RCB) regime

The UK covered bond market was established in July 2003 under a general law framework. In March 2008 the Treasury introduced the 'Regulated Covered Bond Regulations 2008' (the Regulations), which provide a dedicated legal framework for the UK market. The Regulations and [RCB Sourcebook](#) were amended respectively in November and December 2011 following consultation feedback from the Treasury and our predecessor organisation, the [FSA](#). These amendments came into force in January 2013 and are in line with recommendations published by the European Banking Authority in 2014.

To date, 12 RCB programmes have been registered. Some structured (unregulated) covered bond programmes also exist but do not fall within the remit of the FCA.

RCB issuers

- Abbey National Treasury Services plc
- Barclays Bank plc
- Bank of Scotland plc
- Clydesdale Bank plc
- Co-operative Bank plc
- Coventry Building Society

- HSBC Bank plc
- Leeds Building Society
- Lloyds Bank plc
- Nationwide Building Society
- The Royal Bank of Scotland plc
- Yorkshire Building Society

For further information, please see [RCB Register](#).

Key features of the RCB regulations

- Only deposit-taking institutions with headquarters in the UK can become issuers of RCBs and the Special Purpose Vehicle (SPV) holding the cover pool must also be based in the UK.
- Only eligible property as defined in legislation can be used as collateral in RCB programmes.
- The Regulations provide for the full segregation of the asset pool from the issuer in a separate legal entity (the SPV) on which bondholders have a priority claim if the issuer becomes insolvent.
- The Regulations require the assets backing RCBs to be maintained in a way that ensures 'a low risk of default in the timely payment' of the bonds. This requirement continues to apply if the issuer defaults.

What are the benefits?

The market benefits investors in the following ways:

Increased investment limits: UCITS schemes and non-UCITS retail schemes can hold up to 25% of their assets in RCBs issued by one issuer, compared to 5% in the case of structured (unregulated) covered bonds; although UCITS schemes will need to ensure that when they invest more than 5% in covered bonds issued by a single body, the total value held must not exceed 80% in value of the scheme property of the UCITS ([COLL 5.2](#) and [COLL 5.6.7R](#)).

From the start of the Solvency II directive on 1 January 2016, insurers (other than small non-directive firms) can invest freely in RCBs, subject to their risk appetite and the constraints of their capital requirements and the Prudent Person Principle. For non-directive firms the current PRA rules will continue. These allow non-directive insurance companies to take credit for up to 40% of the value of their assets held in RCBs issued by a single approved counterparty, but only 5% in structured (unregulated) covered bonds issued by a single approved counterparty. For more details on the rules see [INSPRU 2.1.22R \(3\)\(b\)](#).

Preferential prudential risk weighting: the following may benefit from a preferential regulatory capital requirement reduction in risk weight of up to 60%:

- investors subject to the CRD with an exposure to covered bonds which meet the requirements in article 129 of the [EU Capital Requirements Regulations \(EU No. 575/2013\)](#) (the CRR);
- investors not subject to the CRR with an exposure to covered bonds which meet the requirements in [BIPRU 3.4.106R](#) to [BIPRU 3.4.110R](#).

Our role

We supervise RCBs and associated programmes. To supplement the Regulations, we set out legally enforceable directions and guidance relating to RCBs and RCB programmes in our [RCB Sourcebook](#).

We provide further guidance outside the RCB Sourcebook to set out our minimum expectations on the following:

- role of the [compliance function](#);
- role of the [signatory of the annual confirmation of compliance, the content of Management Information and the appropriateness of systems and controls within RCB programmes](#); and
- the role of [Asset Pool Monitor](#).

In discharging our supervisory duties, we must have regard to maintaining the reputation of, and investor confidence in, the market for UK RCBs.

We organise and host the UK RCB Forum, an industry forum to promote awareness of new and emerging issues and engage in dialogue with key stakeholders.

Applying for RCB status

We conduct a two-stage assessment of applications for regulated status, comprising a review of the programme structure together with relevant documentation and an on-site review. We assess prospective programmes against the criteria set out in the Regulations and Sourcebook. This includes a review of:

- the competency of the proposed oversight and governance framework in prudently managing risks of the programme;
- the systems, controls, policies and procedures in relation to risk management, underwriting, arrears and valuation, as well as compliance with the Regulations;
- the proficiency of cash management and servicing functions;
- the quality of eligible assets in the cover pool (considering borrower history, income verification, loan-to-value [LTV] ratios, income multipliers, arrears, seasoning, loan purpose, property types and terms of the loans);
- the availability of the assets in the cover pool to mitigate the various risks inherent in their programmes such as asset-liability mismatching, market value, interest rate and currency risks;
- the ability of the assets on the issuer's balance sheet to be substituted in to meet cover pool requirements;
- the ability of the programme to make timely payment on outstanding regulated covered bonds;
- the legal structure's compatibility with the Regulations; and
- independent legal and audit opinions on the compliance of the issuer and programme with the Regulations.

Ongoing supervision

We monitor each RCB programme's ability to meet its obligations and regularly assess each issuer's fitness to comply with its obligations under the Regulations.

We stress test RCB programmes once a quarter, when a new bond is issued and on an ad hoc basis (e.g. to assess the impact of any significant changes made to a programme).

Stress testing results monitor over-collateralisation requirements for each RCB programme.

Our stress testing is independent of any analysis undertaken by other parties such as issuers themselves using syndicated models, credit rating agencies or contractual tests built into programme structures.

Key variables in the FCA's cashflow modelling:

- default rate and timing;
- loss severity and timing;
- refinancing sale price of assets;
- prepayment rate and timing;
- resilience of counterparties and hedges;
- movements and interactions of interest rates such as Libor, base rate and issuer SVRs;
- off-sets;
- GIC rate; and
- servicing costs.

We incorporate into our modelling the:

- actual asset characteristics (e.g. asset type, amortisation profile, interest characteristics);
- outstanding liabilities (e.g. maturity, coupon and currency characteristics); and
- structural features (e.g. derivative mechanics, reserve funds, extension period optionality and minimum yield requirements).

We typically conduct annual reviews of each RCB programme, assessing the issuer's continuing ability to meet the standards set out in the Regulations and Sourcebook.

Issuers must seek our approval before making any material changes to RCB programmes. We will assess the impact of any material changes proposed against the programme's ability to comply with the requirements under the Regulations. For this level of oversight to be carried out, issuers must provide us with but not limited to:

- annual attestations by senior management that the programmes comply with the Regulations;
- quarterly cover pool information including loan characteristics on both stratified and loan-by-loan basis;
- prior notification of, and information related to, each RCB issuance before they issue it;
- programme documentation as and when they are updated; and
- notification of any proposed significant changes to the programme, etc.

Changes to the regulatory reporting came into effect on January 2013 and include:

- prior notification by issuers of each RCB cancellation;
- notification of any significant substitutions made to the cover pool resulting in a change of the level of over-collateralisation of 5% or more;
- quarterly information on the asset and liability profile; and
- monthly cover pool information.

We have a wide range of enforcement powers to ensure issuers and owners comply with the Regulations. This includes the power to issue directions, de-register issuers or fine persons for any breaches of the requirements placed on RCB programmes.

If an issuer of RCBs becomes insolvent, we will continue to supervise the SPV (owner) holding the cover pool and the outstanding regulated covered bonds. The UK legal framework allows us to issue direction or take enforcement action against the SPV.

Transparency

Issuers must make a number of public disclosures:

- the designation of asset pools as composed of a single class of eligible assets or a mixture of eligible asset classes
- the provision of the following information on a secure, subscription-only website:
 - key transaction documents;
 - a link to the latest programme prospectus;
 - characteristics of the asset pool each month;
 - loan-level information on the asset pool each quarter following any issuance of RCBs after 1 January 2013.

Need to know more?

For further information, please contact:

RCB@fca.org.uk