Financial Services Authority

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FSA®

23 April 2012

Office of the Comptroller of the Currency
250 E Street SW.
Mail Stop 2–3
Washington, DC 20219
Re: Docket ID OCC–2011–14

Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
Re: Docket No. R–1432 and RIN 7100 AD 82

Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429
Re: RIN 3064–AD85

Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549
Re: File Number S7–41–11

Commodity Futures Trading Commission
1155 21st Street, NW.
Washington, DC 20815
Re: RIN 3038-AD05

Re: Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds

I would like to take the opportunity, following a call with SEC staff on 6 March 2012, to provide comments on the proposals published by the U.S. agencies regarding banks' proprietary trading and relationships with hedge funds and private equity funds (the "Proposed Rule"). More specifically, I would like to draw your attention to some concerns relating to the application of the Proposed Rule to UK Regulated Covered Bond arrangements. Please consider this letter as a supplement to our earlier correspondence dated 8 February 2012 on other aspects of the Proposed Rule (which I attach to this letter for ease of reference).

I would also refer you to a letter addressed to yourselves by the UK Regulated Covered Bond Council (UKRCBC) on 13 February 2012 (which I also attach to this letter) which sets out the comments and concerns of the UK issuers of regulated covered bonds regarding the Proposed Rule - concerns which the FSA shares with the UKRCBC.

The FSA supervises regulated covered bond programmes and issuers in the UK. The Regulated Covered Bond regime was introduced in the UK in March 2008 with the coming into force of the *Regulated Covered Bond Regulations 2008*[1] *("the Regulations")* which provides a dedicated legal and regulatory framework for covered bonds and issuers of such covered bonds issued under this framework. As a supplement to the Regulations, legally enforceable directions and guidance are set out in the FSA Sourcebook[2]. The Regulations aim to improve UK banks and building societies' access to funding, by providing a UCITS compliant legal framework for issuing covered bonds. Our role as designated supervisor of the regime is to monitor the level and quality of assets in the programmes and the issuers' compliance with their obligations under the Regulations and Sourcebook on an ongoing basis. In discharging our duties, we must have regard to maintaining the reputation of, and investor confidence in, the market for UK regulated covered bonds (The Regulated Covered Bonds Regulations 2008, Regulation 6). In addition, the FSA has statutory responsibility for prudential supervision of U.K.-incorporated banks, several of whom have material operations in the U.S.

While we understand the rationale of imposing restrictions on proprietary trading by U.S. firms, we are concerned that, in the absence of clarification, the Proposed Rule may unintentionally interfere with U.K. covered bond structures and as a result have potential negative implications for U.K. banks and possibly the U.K. economy more widely. This could in turn impact our ability to fulfil our regulatory duties.

Covered bonds are a type of secured bond that is usually backed by mortgages or public sector loans. In the U.K., regulated covered bond structures involve a separate special purpose vehicle which holds the collateral pool and guarantees payments under the covered bonds pursuant to a guarantee which is secured over such pool (the "Asset Pool Owner"). In order for such covered bonds to achieve the intended economic effect of holding dual recourse, to both the bank issuing the instrument and the collateral pool, the issuing bank (which we note would fall under the definition of "banking entity" under the rule) enters into a number of transactions with the Asset Pool Owner. This includes transactions where the bank takes on credit exposure to the Asset Pool Owner (e.g. through derivatives and securities lending transactions, provision of loans and/or investment in securities of the Asset Pool Owner).

We also note that covered bond structures, which must be issued by deposit-taking institutions with their headquarters in the U.K., involve a number of further transactions where services are provided by the issuing bank for the Asset Pool Owner. These typically include asset and liability management services.

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[1] http://www.legislation.gov.uk/uksi/2008/346/contents/made

[2] http://fsahandbook.info/FSA/html/handbook/RCB

We understand that the Proposed Rule prohibits banking entities from (a) sponsoring or retaining as principal an ownership interest in a covered fund, and/or (b) entering into a covered transaction with a related covered fund for which it serves as sponsor, investment manager or investment advisor. We believe that this prohibition could apply to U.K. covered bond structures given i) the wide definition of "covered fund" which, in the absence of further clarification, could potentially include the Asset Pool Owners in UK covered bond structures; and ii) the points of connection described above between U.K. banking entities and U.K. Asset Pool Owners. Moreover, some of the transactions entered into by the issuing bank may be interpreted as a "covered transaction" with a covered fund for the purposes of section 23A of the US Federal Reserve Act (the "Super 23A Restriction"). We note that Asset Pool Owners could also fall under the definition of "banking entity" since the issuing bank is typically one of the Asset Pool Owner's members.

We do not believe it is the intention of Proposed Rule to interfere with UK covered bond structures (or indeed covered bond structures in other jurisdictions), but these uncertainties, if not appropriately addressed, could adversely impact the ability of U.K. banks to finance themselves through covered bond transactions.

Covered bond markets have demonstrated their relative resilience even in distressed market conditions and, following the crisis, have grown to make up for some of the loss of other sources of funding. The FSA and the U.K. Government are committed to supporting the development of a strong regulated covered bond market in the UK, which currently represents an outstanding sterling equivalent value of over GBP120 billion[1]. Covered bonds remain an invaluable funding tool for EU credit institutions. Therefore any uncertainty with respect to the position of covered bond structures under the Proposed Rule should as a result be avoided.

Against this background, we ask for clarification of the scope of U.K. covered bonds under the Proposed Rule, for a lack of such clarification will serve to create uncertainty for market participants, which would be detrimental for these institutions. In particular, I believe that special focus should be given to the definitions of "covered fund" and "banking entity" to ensure that these definitions do not inadvertently capture the Asset Pool Owners in covered bond structures.

Should you have any questions on this letter, please do not hesitate to contact me.

Yours sincerely

David Lawton

David Lawton
Acting Director of Markets

[1] http://www.fsa.gov.uk/fsaregister/use/other_registers/rcb_register

Financial Services Authority

From the Chairman
Adair Turner

Direct line: 020 7066 3000
Local fax: 020 7066 1011

Ben Bernanke
Chairman
Board of Governors of the Federal Reserve System
Eccles Board building
C Street NW (between 20th & 21st Streets)
Washington DC 20551
USA

08 February 2012

Our Ref: CW

<u>Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds</u>

Dear Ben

I would like to take the opportunity, following the Chancellor of the Exchequer's letter to you (23 January 2012), to comment further on the proposals published last year by the U.S. regulatory agencies regarding banks' proprietary trading and relationships with hedge funds and private equity funds (the Volcker Rule). As you are aware, the Financial Services Authority is the United Kingdom's integrated financial regulator responsible for prudential and conduct of business supervision. As such, it has statutory responsibility for supervising U.K.-incorporated banks, several of whom have material operations in the U.S. and act as major counterparts to U.S. banks. It is also responsible for the oversight of U.K.-based asset managers and U.K. financial markets.

We sympathise with the central intent of the Volcker Rule as one of several measures in the Dodd-Frank Act aimed at enhancing the resilience of U.S. banks. There is wide recognition globally of the need to take strong action that will help to ensure we avoid any repetition of the stresses that the banking sector has experienced in recent years. This has prompted considerable efforts internationally, and we have worked closely within the Financial Stability Board and the Basel Committee with U.S. colleagues and others to this end. In the U.K., the recommendations of the Independent Commission on Banking (ICB), which have now been accepted formally by the government, will result in additional domestic reform measures. A shared objective of both the U.S. and the U.K. domestic reform programmes is to restrict the ways in which trading activity can threaten the safety and soundness of commercial banks – in our case, the ICB proposals envisage ring fencing retail and SME deposits and overdrafts (at a minimum) from wholesale and trading operations.

However, while we concur with the rationale of imposing restrictions on proprietary trading by U.S. firms, we believe that the proposed approach to implementation will have extra-territorial effects on firms that are already subject to overseas regulatory regimes, and may

Permitted activities relating to government bonds and liquidity management

The U.K. Chancellor has already referred to the adverse impact that the Volcker Rule could have on sovereign debt markets. Your published proposals include an exemption for trading in U.S. government obligations and those of certain U.S. public agencies. As a prudential and market regulator, we can see the logic of this exemption. Your consultation document asks whether the U.S. regulatory agencies should adopt an additional exemption for proprietary trading in the obligations of foreign governments. We believe that the same logic which has led you to exempt U.S. government bonds applies to similar overseas obligations (such as U.K. government bonds).

Government debt and related obligations are a major constituent of the banking sector's liquid assets. It is therefore essential that banks are able to manage the stock of liquid assets dynamically over time. In addition to the exemption for U.S. government bonds, the proposals include an exclusion for positions acquired or taken for liquidity management purposes (but subject to various tests). This issue is an important one from a safety and soundness perspective. Consequently, we wish to underline the importance of this and the other exclusions (e.g. certain repurchase arrangements or those relating to transactions by foreign banks), and the importance of applying them in a manner that does not constrain banks, particularly those outside the U.S., from engaging in active liquidity management. In addition to bonds issued by governments outside the U.S., this issue is also relevant to other assets that are accepted as liquid reserves under local legislation. Trading liquidity in some markets will be less deep than that for U.S. Treasury obligations; it is therefore important that the tests for assessing bona fide liquidity management take account of this.

Foreign banking entities exemption and market making exclusions

Section 619 of the Dodd-Frank Act includes an exemption for transactions that take place outside of the U.S. In the implementation proposal, the U.S. agencies have adopted a tightly-drawn definition of an overseas trade, so that for a transaction to take place outside the U.S. each of four conditions must apply: (i) the transaction is conducted by a banking entity that is not organised under U.S. law, (ii) no party to the transaction is a U.S. resident, (iii) no personnel of the banking entity that is directly involved in the transaction is physically located in the U.S.; and (iv) the transaction is executed entirely outside the U.S.

As a general comment, we do not believe any implementing measure should seek to impose a narrower definition of a transaction involving foreign banking entities than is required by primary legislation. More specifically, the consultation text asks whether respondents would like further clarification about the scope of these terms. We believe the U.S. agencies should achieve an outcome where the use of custody and settlement services, trade facilitation services or other infrastructure provided or supported by a U.S. entity is not sufficient by itself (i.e. without the assumption of the risks and potential profit opportunities of proprietary trading) to call into question a transaction's eligibility for the foreign banking entities exemption. This appears consistent with the safety and soundness goals at which the Volcker Rule aims.

Questions also arise as to the interaction of the market maker exemption and the requirements as they relate to foreign banking entities in non U.S. markets. If a U.K.-incorporated bank with a U.S. affiliate engages in a transaction in the U.K., or a third country, with a U.S. bank that acts as a market maker under the market maker exemption, it will seemingly be unable to take account of any exemption relating to trades outside the U.S. We would be interested in exploring or obtaining clarification on how such transactions will be viewed. Uncertainty about the delineation of the exemption requirements might reduce some useful trading activity without yielding off-setting prudential gains.

I and my colleagues welcome the opportunity to comment and are happy to engage in further dialogue.

I am copying this letter to Chancellor of the Exchequer, Her Majesty's Treasury and to the Heads of the OCC (John Walsh), SEC (Mary Schapiro), FDIC (Martin Gruenberg) and CFTC (Gary Gensler).

Yours

Adair Turner

UKRCBC
Regulated Covered Bond Council

13 February 2012

Submitted via electronic submission

Office of the Comptroller of the Currency
250 E Street SW.
Mail Stop 2–3
Washington, DC 20219

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street NW.
Washington, DC 20429

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street NE.
Washington, DC 20549

Re Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships with, Hedge Funds and Private Equity Funds; OCC: Docket ID OCC–2011–14; **FRB:** Docket No. R–1432 and RIN 7100 AD 82; **FDIC:** RIN 3064–AD85; **SEC:** File Number S7–41–11

On behalf of the UK Regulated Covered Bond Council (the **RCBC**), we welcome the opportunity to provide comments on the joint notice of proposed rulemaking described above (the **Proposed Rule**) as issued by the U.S. agencies addressed above (the **Agencies**). The Proposed Rule would implement Section 619 of the Dodd-Frank Act. The RCBC members are comprised of the UK Regulated Covered Bond issuers, which issuers include certain UK credit institutions with a U.S. branch. Further information with respect to the RCBC and its members is set out in Annex I.

As a starting point, we join other industry groups in expressing general concern about the broad implications and unintended consequences of the restrictions contemplated by the Proposed Rule with respect to the ability of banking entities to sponsor and invest in, and to have other relationships with, entities regarded as covered funds. We do not propose to explore these general concerns in this response letter, however, and our comments are instead focused on the effect of the Proposed Rule on UK covered bond arrangements.

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In summary, we are concerned that, as currently drafted and in the absence of clarification, the Proposed Rule may interfere with and effectively restrict aspects of existing UK covered bond structures where such transactions involve a relevant banking entity. Such an outcome is not justified and would not reflect the legislative intention behind Section 619 of the Dodd-Frank Act (i.e. to prevent banking entities from having excessive financial exposure to private equity funds and hedge funds engaged in trading and other investment activities deemed to be speculative). Moreover, such an outcome would have a negative and disproportionate effect on UK banks (in particular on their mainstream wholesale funding activities), and would give rise to potential conflicts with the legislative framework which applies to Regulated Covered Bonds in the United Kingdom.

There is no suggestion in Section 619 of the Dodd-Frank Act or in the Proposed Rule that covered bond issuance activities of non-U.S. banks are intended to be limited and/or prohibited by the restrictions contemplated therein and, as such, it seems likely that the potential implications for UK covered bonds are largely unintentional. The significance of the issues at stake, however, should not be underestimated. We note that covered bonds have proved to be an invaluable funding tool for EU credit institutions during the financial crisis. The UK Government has recently reiterated its support for the UK covered bond market and has formally confirmed that it considers covered bonds to be an important source of longer-term, more stable funding.[1] The sterling equivalent value of outstanding covered bonds issued under the UK framework has exceeded GBP100 billion (approximately USD157 billion).[2] Indeed, some GBP30 billion (USD47 billion) has been issued in the last 12 months alone, when unsecured wholesale markets have been disrupted.

It should be noted that the issues identified under the Proposed Rule in respect of UK covered bond structures would also be relevant in principle in respect of covered bond structures used in certain other EU jurisdictions (e.g. The Netherlands and Italy) and certain non-EU jurisdictions (e.g. Canada, Australia and New Zealand).

We urge the Agencies to take action in the final rules made under Section 619 of the Dodd-Frank Act to make it clear that such rules would not apply in respect of UK covered bond structures (and similar covered bond structures used in other jurisdictions). A failure to provide appropriate clarification could have significant implications for relevant UK covered bond issuers, and on the funding of real economy assets in the UK in general.

Our more detailed comments are set out below. We would be happy to discuss our response with you at your convenience.

Background

Covered bonds generally

Covered bonds are full recourse debt instruments typically issued by an EU credit institution that are fully secured or "covered" by a pool of high-quality on-balance sheet collateral (e.g. residential or commercial mortgage loans or public sector loans). By their nature, covered bonds are dual-recourse instruments (i.e. they offer investors recourse on the bank issuer as well as on the collateral pool). The majority of European covered bonds are issued under specific legislative frameworks which implement the defining characteristics of covered bonds set out in Article 52(4) of the EU UCITS Directive.[3]

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[1] http://cdn.hm-treasury.gov.uk/condoc_covered_bonds_summary_responses.pdf
[2] For further information on the UK covered bond market, see the document linked here http://www.hm-treasury.gov.uk/d/consult_review_uk_reg_framework_covered_bond.PDF.
[3] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:302:0032:0096:EN:PDF

Broadly, there are two main models used for covered bond structures in Europe – the integrated model (where the collateral pool continues to be owned directly by the bank issuer and is segregated by special legislation) and the structured model (where the pool is transferred to a special purpose vehicle and is segregated by operation of legal principles). These arrangements are regarded as achieving the same key outcome (i.e. segregation and protection of the collateral pool in favour of the bondholders) and, in general, the model used by issuers will often be determined by the one provided for under the specific legislative framework which applies in the relevant jurisdiction. No distinction is drawn between covered bonds issued under these models in terms of the less restrictive investment rules and/or preferential risk weightings that are made available under European legislation in respect of certain covered bonds.

UK covered bonds

The first UK covered bonds were issued in 2003. To support further development of the UK covered bond market, the UK Government introduced a special legislative framework in 2008 (which regime was reviewed and confirmed in 2011). The UK regime (which applies in respect of Regulated Covered Bond issues) provides for use of the structured model only and effectively endorses the contractual arrangements used by UK issuers prior to the introduction of the regime.

As such, all UK covered bond programmes (including those registered under the legislative framework) involve a separate special purpose vehicle (the **Asset Pool Owner**) which purchases and holds the collateral pool and guarantees payments under the covered bonds pursuant to a guarantee which is secured over the collateral pool. All UK Regulated Covered Bond issuers currently only use residential mortgages in their programmes, but the range of eligible assets under the legislative framework is much broader.

UK covered bond structures involve a number of points of connection between the bank issuer and the Asset Pool Owner. Among other things:

- the Asset Pool Owner will generally be established as a subsidiary of the bank issuer (i.e. as an English limited liability partnership in respect of which the bank issuer is a member) and with a similar name to the bank issuer;
- the bank issuer will make term advances to the Asset Pool Owner under an intercompany loan agreement, the proceeds of which advances will be used for specified purposes, including to purchase the collateral pool from the bank issuer;
- the bank issuer may repurchase certain assets from the Asset Pool Owner;
- the bank issuer may act as swap counterparty with respect to hedging transactions entered into by the Asset Pool Owner to hedge certain interest rate, currency or other risks in respect of amounts received by the Asset Pool Owner under the collateral assets; and
- the bank issuer will provide certain services to the Asset Pool Owner, including cash management services which will include investing certain amounts in authorised investments in certain circumstances.

Further detailed information on UK covered bonds is set out in Annex II.

It should also be noted that bank issuers may purchase and hold "own-name" covered bonds. Both the Bank of England and the European Central Bank permit eligible counterparties to use certain own-name covered bonds as collateral in their liquidity providing operations.

As noted above, similar covered bond structures are used in certain other EU jurisdictions (e.g. The Netherlands and Italy) and certain non-EU jurisdictions (e.g. Canada, Australia and New Zealand) (although it is not always the case that the asset pool owning entity will be established as a subsidiary of the relevant banking entity).

Key comments

As noted above, we are concerned that, as currently drafted, the Proposed Rule may interfere with and effectively restrict aspects of existing (and new) UK covered bond structures.

Asset Pool Owners should not be covered funds

Our key concerns in respect of the Proposed Rule arise primarily due to the wide definition of "covered fund" used in the Proposed Rule and the fact that it is not sufficiently clear that Asset Pool Owners used in UK covered bond structures would not fall within the definition as proposed.

We note that Section 619 of the Dodd-Frank Act prohibits banking entities (including certain non-U.S. banks) from, among other things, (a) sponsoring or acquiring or retaining an ownership interest in a "private equity fund" or a "hedge fund" (collectively referred to as "covered funds" in the Proposed Rule) (the **Ownership Restriction**) and/or (b) entering into "covered transactions" (as defined in Section 23A of the U.S. Federal Reserve Act) with any covered fund for which it serves as sponsor, investment manager or investment adviser (the **Super 23A Restriction**).

Tracking the wide definition used in Section 619 to define relevant fund entities, the Proposed Rule indicates that the term "covered fund" means any company that would be an investment company under the U.S. Investment Company Act of 1940 but for the exemptions set out in Section 3(c)(1) or Section 3(c)(7) of that Act. The Proposed Rule also seeks to further widen the covered fund definition by indicating that relevant entities will include any company that would be an issuer under the Act but for the exemptions outlined above if such issuer were (hypothetically) organised under the laws of, or offered securities to one or more residents of, the United States.

Given the wide definition of covered fund and the foreign equivalency provisions discussed above (and also taking into account discussions separate from the Volcker Rule which suggest that certain U.S. agencies may take action to revise the terms of certain other exemptions under the Investment Company Act, including the exemption set out in Section 3(c)(5)), it is not sufficiently clear that Asset Pool Owners (as providers of a guarantee) would not be regarded as an issuer within the scope of the definition.

Taking into account the intention behind Section 619, this is not an appropriate outcome and such a result has the potential to create significant issues for the UK covered bond market given the wide restrictions contemplated by the Volcker Rule. In particular, in the absence of clarification, certain common points of connection between the bank issuer and the Asset Pool Owner outlined above may be prohibited. Moreover, such an outcome may result in certain arrangements which are expressly permitted (and indeed required) by the UK covered bond legislative framework (including the use of Asset Pool Owners in general) being restricted under the Volcker Rule, effectively putting relevant issuers in a position of being subject to conflicting laws. From a policy perspective, it would seem appropriate for the UK authorities to regulate the structure to be used in the context of UK Regulated Covered Bond transactions (as they have done), but the rationale for the application of a conflicting U.S. law in this regard is unclear.

There is no suggestion in Section 619 of the Dodd-Frank Act or in the Proposed Rule that covered bond issuance activities of non-U.S. banks are intended to be limited and/or prohibited by the restrictions contemplated therein and, as such, it seems likely that the potential implications for UK covered bonds are largely unintentional. Any uncertainty with respect to the position is cause for significant concern, however, and must be addressed to ensure that issues do not arise.

We note that U.S. Congress specifically sought to avoid restricting the ability of banking entities to engage in securitisation activities under Section 619 by including an express provision that nothing therein was to be "construed to limit or restrict the ability of banking entities or nonbank financial companies … to sell or securitise loans in a manner otherwise permitted by law". In principle, given the extraterritorial reach of the Proposed Rule, we consider the policy reasons which justified the provision of this protection for securitisation as a funding source should also justify the provision of protection for other essential bank funding sources used in other jurisdictions, such as covered bonds. We suspect that specific protections were not built into Section 619 for covered bonds because it was assumed that such arrangements would not be affected (possibly on the assumption that only integrated model structures are used), or possibly as a result of the lack of a developed U.S. covered bond market (meaning that Congress may not have focused on covered bonds). In any event, as noted above, a lack of certainty as to the position of UK covered bond structures would have a negative and disproportionate effect on UK banks and possibly on the wider UK economy and, as such, must be addressed.

Our members urge the Agencies to take action in the final rules made under Section 619 of the Dodd-Frank Act to make it clear that relevant covered funds (for the purposes of both the Ownership Restriction and the Super 23A Restriction) would not include Asset Pool Owners used in UK covered bond structures. We consider that this could be achieved by clarification of the proposed covered fund definition to more specifically identify those entities intended to be within scope (i.e. hedge funds and private equity funds) and by provision for an express exemption for covered bond vehicles. We consider that the case for taking such action is clearly made.

Asset Pool Owners should not be banking entities

As Asset Pool Owners may be subsidiaries of relevant banking entities, it is also necessary for a clear exemption to be provided for such vehicles from the definition of "banking entity". In the absence of this clarification, the activities of Asset Pool Owners may be restricted to the extent that such activities may be construed to fall within the widely cast proprietary trading restriction and/or within the range of restricted activities and transactions vis-à-vis covered funds.

From a policy perspective and given the legislative intention underpinning the Volcker Rule, Asset Pool Owners should not be regarded as banking entities for the purpose of the Rule. It would appear likely that the potential implications in this regard are largely unintentional. However, once again, a lack of certainty as to the position of vehicles used in UK covered bond structures would have a negative and disproportionate effect on UK banks. On this basis, we urge the Agencies to make the position of Asset Pool Owners clear on this front as well by providing for an express exemption from the banking entity definition for such entities.

As noted above, covered bonds have proved to be an invaluable funding tool for EU credit institutions during the financial crisis and the sterling equivalent value of outstanding covered bonds issued under the UK framework has exceeded GBP100 billion (approximately USD157 billion).[4] Any uncertainty with respect to the position of covered bond structures under the Volcker Rule should be avoided and we strongly urge the Agencies to provide the clarifications described herein.

Thank you once again for the opportunity to comment on the issues raised in the Proposed Rule. Should you have any questions or require any additional information regarding any of the comments set out above (including with respect to the requested exemption and how this could be drafted to properly exempt relevant vehicles), please do not hesitate to get in touch with the undersigned.

Chris Fielding, Executive Director
UK Regulated Covered Bond Council

CC: Christian Moor, European Banking Association
CC: Anna Simons, UK Financial Services Authority
CC: Eleanor Riley, HM Treasury

[4] For further information on the UK covered bond market, see the document linked here http://www.hm-treasury.gov.uk/d/consult_review_uk_reg_framework_covered_bond.PDF.

ANNEX I

The UK Regulated Covered Bond Council (**RCBC**) was formed in 2009. The purpose of the RCBC is to represent UK Regulated Covered Bond issuers in discussions with regulators, legislators, rating agencies and other trade bodies.

The objectives of the RCBC are:

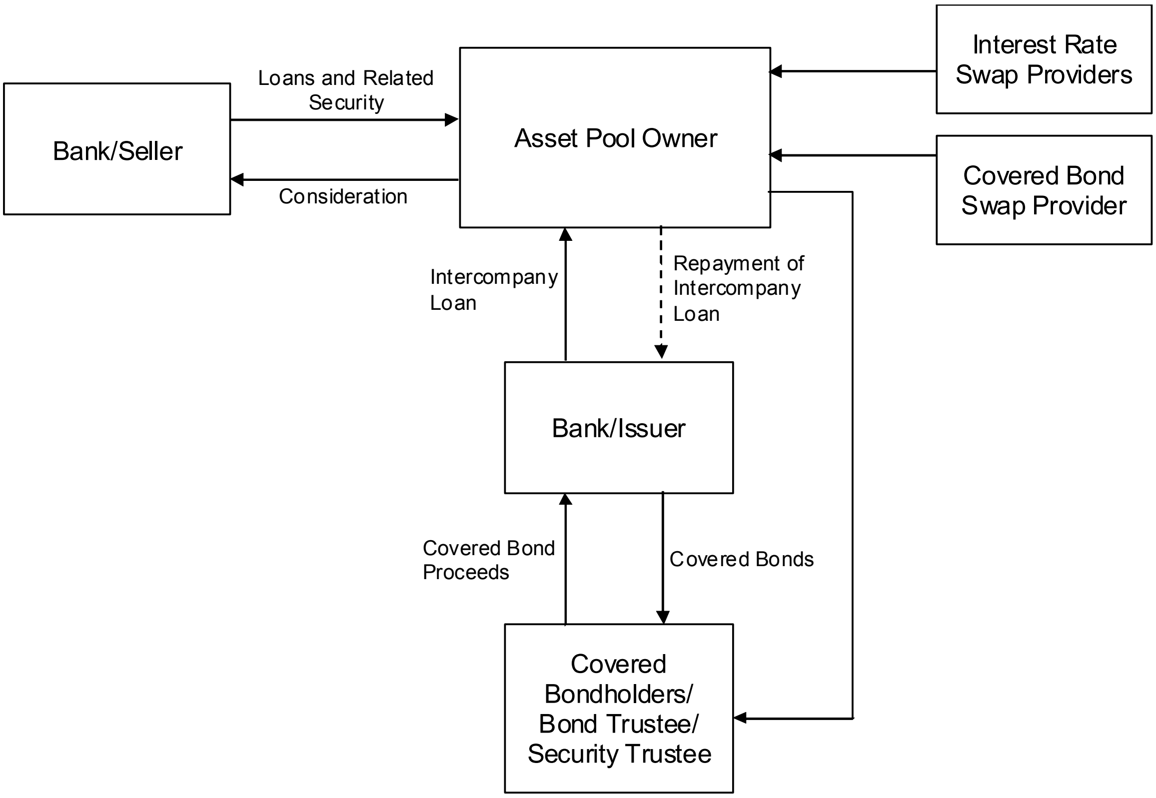
- to promote the UK Regulated Covered Bond product;
- to collect, produce and disseminate information and analysis relevant to UK Regulated Covered Bonds;
- to promote best practice and, to the extent possible, common standards in investor reporting, modelling asset capability and other similar areas; and
- to foster relationships and synergies and to campaign for RCBC interests with other industry members (legal counsels, investment banks, trustee and corporate services providers) and other national or multi-jurisdictional industry associates.

The RCBC members include:

- Abbey National Treasury Services plc
- Bank of Scotland plc
- Barclays Bank plc
- Coventry Building Society
- Clydesdale Bank plc
- HSBC Bank plc
- Leeds Building Society
- Lloyds TSB Bank plc
- Nationwide Building Society
- The Royal Bank of Scotland plc
- Yorkshire Building Society

ANNEX II

Structure diagram



Structure overview

- The UK structure involves a UK bank or building society either directly, or through a subsidiary, issuing covered bonds through a medium term note programme. The covered bonds constitute direct, unsecured and unconditional obligations of the issuer.

- The issuer will lend the proceeds of the covered bonds to a special purpose vehicle, established as a UK limited liability partnership and which is a subsidiary of the issuer – i.e. the Asset Pool Owner.

- The Asset Pool Owner will in turn use the proceeds of such loan to purchase mortgage loans from the issuer (or an affiliate of the issuer) or to refinance an existing series of covered bonds.

- The loan made by the issuer to the Asset Pool Owner will not be repaid unless and until such time as the related series of covered bonds has been discharged in full.

- The Asset Pool Owner will guarantee the obligations of the issuer under the covered bonds. The Asset Pool Owner's obligations under the guarantee will be secured by its interest in the cover pool (including the mortgage loans and certain substitution assets) and any other assets of the Asset Pool Owner.

- In the event that the issuer fails to meet its obligations under the covered bonds, although the trustee will accelerate the claims as against the Issuer, the assets (including the cover pool) of the Asset Pool Owner will be utilised to ensure the covered bonds are serviced to their original maturity. It is only on the occurrence of an event of default with respect to the Asset Pool Owner that the covered bonds are accelerated, resulting in the liquidation of the assets.

- As with all covered bonds, the UK structures utilise an asset coverage test designed to ensure that the mortgage loans and other substitution assets comprised in the cover pool, taking into account certain discounts to the principal balance of the loans (such as a maximum loan to value ratio and deductions for delinquencies and set-off risk), will be sufficient to service the covered bonds to their designated maturity.

- In the event that the Asset Pool Owner is required to make payments to the covered bondholders under the guarantee, an additional test (an amortisation test) is intended to ensure that the principal balance of the mortgage loans and the substitution assets (calculated on an adjusted basis to take account of any delinquent mortgage loans and the weighted average term to maturity of the then outstanding covered bonds) is at least equal to the outstanding principal balance of the covered bonds.