EXPLANATORY MEMORANDUM TO

THE REGULATED COVERED BONDS (AMENDMENT) REGULATIONS 2012

2012 No. 2977

1. This explanatory memorandum has been prepared by HM Treasury and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 To amend the Regulated Covered Bonds (Amendment) Regulations 2011 (S.I. 2011/2859) ("the 2011 Regulations") to modify the application of the overcollateralisation test set out in the 2011 Regulations so that it is in line with the original policy intention as set out in the impact assessment to the 2011 Regulations.

3. Matters of special interest to the Joint Committee on Statutory Instruments

3.1 None

4. Legislative Context

4.1 The Regulated Covered Bond Regulations 2008 (S.I. 2008/346) ("the Regulated Covered Bonds Regulations") provide for the establishment of a UK covered bonds regime that is compliant with Article 52(4) of Council Directive 2009/65/EC of 13 July 2009 (which replaced Article 22(4) of Council Directive 85/611/EC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ("UCITS Directive").

4.2 The 2011 Regulations amend the Regulated Covered Bond Regulations to improve the protection given to bondholders under the UK covered bond regime. Provision is made for issuers to designate a regulated covered bond as being supported by a single class of assets and liquid assets in an asset pool; and additional obligations are imposed on the issuer, for example to meet a fixed level of overcollateralisation, and to appoint an "asset pool monitor". The 2011 Regulations will come into force on 1 January 2013.

4.3 These Regulations amend the 2011 Regulations before they come into force to specify the extent to which liquid assets may be taken into account for the purposes of the overcollateralisation test set out in the 2011 Regulations.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

6.1 As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 In April 2011, the Government and the FSA published a Review of the UK's regulatory framework for covered bonds and consequently made a number of changes to the Regulated Covered Bond Regulations, including setting a minimum level of credit protection for investors in covered bonds and inserting a definition of liquid assets that could be held in covered bond asset pools.

7.2 As issuers have adapted their systems to meet the requirements, it has become clear that the combination of the overcollateralisation requirement and the definition of liquid assets may have unintended consequences for some issuers and increase the regulatory burden on them, which was not the intended purpose of the original review.

7.3 These amendments specify that:

- Liquid assets (cash and Government debt) are eligible for the purposes of the overcollateralisation test calculation for up to 8% of the value of the bonds outstanding with a maturity of one year or more;
- Liquid assets are eligible for the purposes of the overcollateralisation test calculation for up to 100% of the value of bonds outstanding with a maturity of less than a year;
- Government securities included in single asset class bonds as part of their asset class which also meet the definition of liquid assets shall not be treated as such for the overcollateralization test calculation.

7.4 A consequential change is also made to the date by which issuers have to notify the Financial Services Authority if their bonds are single asset class bonds to take account of the changes made by these Regulations.

7.5 The changes address the unintended consequences that have been identified and will ensure that the legislation operates as originally intended without creating extra burdens for issuers.

Consolidation

7.6 The Treasury does not have plans to consolidate the Regulated Covered Bonds Regulations 2008 at this time. Commercial publishers produce consolidated versions of the Act, and of secondary legislation made under it, both in electronic and hard copy versions.

8. Consultation outcome

8.1 The Government and FSA consulted for 12 weeks in April 2011 on the review of the UK's regulatory framework for covered bonds. The consultation received 16 formal written responses, from both issuers and investors in regulated covered bonds and from a number of other organisations with an interest in the UK covered bond market. The Treasury and the FSA also received informal responses from a number of other firms.

8.2 The majority of respondents agreed with the proposals, which were developed through discussions with industry, and saw them as making UK covered bonds more attractive by bringing them closer into line with European competitors.

8.3 As these amendments ensure the changes made as a result of the 2011 review correctly implement the proposals in that review, a formal consultation was not deemed necessary. The Government and FSA consulted both issuers and investors on the changes through the FSA's Covered Bond Forum, and also met with individual issuers to ensure that the amendments remove the unintended consequences of the 2011 Regulations.

9. Guidance

9.1 The Financial Services Authority will be publishing guidance for issuers and investors.

10. Impact

10.1 These changes will have no impact on business, charities or voluntary bodies as they clarify existing requirements.

10.2 There is no impact on the public sector.

10.3 An Impact Assessment has not been prepared for this instrument as the instrument is designed to bring the regulations in line with the original impact assessment for S.I. 2011/2859.

11. Regulating small business

11.1 The legislation does not apply to small business.

12. Monitoring & review

12.1 The Treasury is required to review the operation and effect of the amendments made by the 2011 Regulations within five years from the date on which they come into force, and publish a report.

13. Contact

Edward Lidington at HM Treasury Tel: 0207 270 5266 or email: ed.lidington@hmtreasury.gsi.gov.uk can answer any queries regarding the instrument.