MARKET NOTICE – EXPANDING ELIGIBLE COLLATERAL IN THE DISCOUNT WINDOW FACILITY AND INFORMATION TRANSPARENCY FOR ASSET-BACKED SECURITIES

1. This Market Notice sets out the results of the Bank of England's recent consultation on broadening the range of collateral eligible in the Bank's Discount Window Facility (DWF) to include loan portfolios; and on the Bank's initiative to require greater information transparency in relation to asset-backed securities and covered bonds (ABS) as part of the eligibility criteria for instruments accepted in its operations. The Bank intends to implement both of these initiatives, with further detail on the criteria and timescales to be announced later in the year.

Eligible Collateral in the Discount Window Facility

2. The Bank intends to extend the range of collateral eligible in the Discount Window Facility to include portfolios of loans to individuals and non-banks. It is expected that this extension will take place during 2011. Detailed terms will be announced in due course.

3. In order for the Bank to be prepared to accept loans as collateral it will require information on the participant's lending procedures and policies including a review of the participant's adherence to these policies (where the Bank will generally seek to rely on an internal auditor's review of the lending procedures, policies and controls) and drawing on the views of the regulator. The Bank would reserve the right to request an independent, third party review if it deemed it appropriate to do so. An additional application process will be established for participants seeking to grant security over loans in the DWF, in order to gather this information. The Bank will require that this process is completed in advance of any request to draw from DWF against loan collateral.

<u>Eligibility criteria</u>

4. Individual loans would need to meet the following eligibility criteria:

   i) Be a residential mortgage, consumer loan (excluding credit cards), commercial real estate loan or corporate loan to a non-bank (including small and medium-sized enterprises);

   ii) The borrower must be domiciled in the United Kingdom with, in the case of a corporate, its centre of main interest also in the UK. The Bank will consider other jurisdictions subject to the participant providing satisfactory legal opinions confirming that the transfer of loans will be enforceable in all the relevant jurisdictions;

iii) Must be denominated in sterling, euro, US dollars, Australian dollars, Canadian dollars, Swedish krona or Swiss francs;

iv) No borrower should currently be in default under any loan (including payment default or arrears). In order to minimise operational complexity in changing the composition of portfolios of loans which have been provided as collateral or pre-positioned, the Bank would be prepared to accept as collateral loans in arrears, but would assign these loans no value;

v) Be governed by the laws of England and Wales, Scotland or Northern Ireland;

vi) Fully drawn, senior, term loans;

vii) Residual loan maturities from a minimum of three months to a maximum of forty years;

viii) The underlying loan documentation must not include restrictions on the disclosure of communications, financial and other information to the Bank, subject to appropriate confidentiality undertakings;

ix) Must have a low expected probability of default, as determined by the Bank, and evidenced by an internally or externally assigned rating or as otherwise agreed with the Bank.

5. Loan portfolios will be subject to both maximum borrower concentration limits and maximum industry concentration limits relevant to that particular loan type. In order to minimise operational complexity in changing the composition of portfolios of loans which have been provided as collateral or pre-positioned, the Bank would be prepared to accept as collateral loan portfolios that breach these concentration limits, but would assign the excess loans zero value. The valuation of any loan portfolio will in part depend on the level of portfolio diversification.

6. The following types of loan will not be eligible:

- Loans to banks, building societies, bank holding companies, and companies within banking groups;
- Loans under partially drawn term loan facilities, where the lender of record may be legally required to provide further advances, or where part of the term loan is made available by letter of credit/bank guarantee;
- Term loan facilities where the Bank's eligibility criteria are met only as a result of any letters of credit/bank guarantees;

- Loans under a revolving credit facility (including credit cards), where the lender of record may be legally required to provide further advances;
- Subordinated debt (including second ranking loans);
- Leveraged loans.

7. As described below due diligence, including a legal review and pool audit, will be required to ensure these requirements are met.

Delivery of loans

8. The portfolios of loans will be provided to the Bank by one of the following mechanisms: declaration of trust; equitable assignment; or a first fixed charge. The form of transfer is to be agreed on a bilateral basis. Legal title will not be transferred (except on default). The permissible forms of transfer may be amended in due course.

9. A participant must pre-position loan portfolios with the Bank before requesting a drawing. Pre-positioning would entail the following:

i) Completion of a review of the loan portfolio by the Bank;

ii) Completion of legal review and pool audit, by suitable independent third parties;

iii) Decision by the Bank as to eligibility and the appropriate haircut(s) to apply;

iv) Monthly reporting of loan level information to the Bank in the same format as the Bank requires for an equivalent ABS. The Bank would also expect weekly reporting of loan balances. Any material changes to drawn portfolios should be reported immediately;

v) Agreed unexecuted legal documentation being in place.

10. Pre-positioning would not involve the transfer or charging to the Bank. It is envisaged that the loan portfolios would be transferred or charged to the Bank at the point of a DWF draw down.

Timescale for implementation

11. A further Market Notice outlining the detailed, finalised requirements applicable to loan portfolios will be published later this year. As described above, it is expected that this extension will take place during 2011.

12. The Bank anticipates that a participant's ability to deliver loan portfolios is likely to increase over time as reporting infrastructure is updated and lending documentation is revised consistent with the Bank's eligibility requirements above. The Bank will risk-manage the existence of set-off rights through its haircuts; participants may therefore wish to remove these rights in new loan agreements, to the extent they are permitted to do so.

Eligibility Requirements for ABS Transparency

13. In order to be eligible for the Bank's operations, the following additional eligibility requirements for asset backed securities and covered bonds will be introduced:

i) Loan level information will be required to be made publicly available at a frequency of not less than quarterly and within a defined period after the relevant bond payment date for the following assets classes: RMBS, covered bonds, CMBS, CLOs, and securitisations of auto, consumer, lease and private student loans. This will be in a format to be determined by the Bank, but the Bank's intention is to be consistent wherever possible with the requirements of other authorities in this area, where these have been defined.

ii) The prospectus, together with the closing transaction documents (excluding legal opinions), will be required to be made freely and publicly available. These will include, but not be limited to: the asset sale agreement (and any relevant declaration of trust), servicing, administration and cash management agreements, trust deed, security deed, agency agreement, incorporated terms or master trust framework or master definitions agreement, swap documentation and liquidity facility agreements, as applicable, as well as any other relevant underlying documentation. Transaction documentation updates must be freely and publicly available.

iii) A transaction summary in a standardised format for any new issuance will be required to be produced and made freely and publicly available.

iv) Standardised monthly investor reports will be required to be provided. These reports will include information on: asset performance; a detailed cash flow allocation; a list of all triggers and their status; a list of all counterparties involved in a transaction, their role and their credit ratings; details of cash injected into the transaction by the originator/sponsor or any other support provided to the transaction including any drawings under or utilisation of any liquidity or credit support and support provided by a third party; amounts standing to the credit of guaranteed investment contract and other bank accounts; details of any swaps (e.g. rates, payments and notionals) and other hedging arrangements to the transaction, including any related collateral postings; and definitions of key terms (such as delinquencies, defaults and pre-payments).

v) A cash flow model will be required to be made freely and publicly available by or on behalf of the originator/issuer.

14. The Bank initially envisages that all of the above information be placed on a website maintained by the issuer/originator (or by another party on their behalf), and that it be made freely and readily available to interested third parties. The Bank would not object to a shared infrastructure being developed but does not intend to mandate this at present.

15. In certain circumstances the Bank may request additional information to support its analysis, including historic performance information.

<u>Timescale for implementation and transition measures for ABS</u>

16. The Bank intends to issue a further market notice later this year setting out full details regarding implementation, including timescales.

17. The Bank's intention is that the publication of transaction documentation, as set out in 12 (ii) above, will be required from July 2011 for all asset classes.

18. It is the Bank's intention to apply its full requirements first to RMBS and covered bonds, for which detailed requirements will be finalised over the summer. The Bank will establish small working groups of market participants in conjunction with the relevant industry bodies to further refine its requirements in the following areas: loan level information, cash flow models, standardised investor reports and standardised transaction summaries. The requirements for other asset classes will be introduced at a later date.

19. Except where explicitly stated these eligibility requirements will apply to all existing and any newly issued securities. The Bank will, for a short period after the implementation period for the new eligibility requirements, continue to accept securities that do not fully meet its requirements, but will apply increasing haircuts. There will be no grandfathering.

20. There will be an implementation period of 12 months allowed for each asset class following the publication of detailed requirements. Implementation periods will commence following publication of

each of the appropriate templates for loan level data, cash flow models, investor reporting and transaction summaries for each asset class by the Bank. More details will be provided in the market notice to be issued later this year.

21. The Bank notes the current lack of standardisation in the use of Credit Bureaux scores, and the constraints over their wider availability, but believes that the public availability of this information would be of benefit. It therefore endorses the proposal made by some issuers and originators to establish a task force to agree how standardised scores will be made publicly available and incorporated in loan and portfolio level reporting.

22. The Bank also notes that there appears to be widespread support for greater pricing transparency and greater standardisation of definitions and looks forward to progress being made in these areas.

Bank of England
19 July 2010