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Our ref:

1 October 2010

CONFIDENTIAL

Dear Sir or Madam –

CP40: CONSULTATION PAPER ON GUIDELINES TO ARTICLE 122A OF THE CAPITAL REQUIREMENTS DIRECTIVE

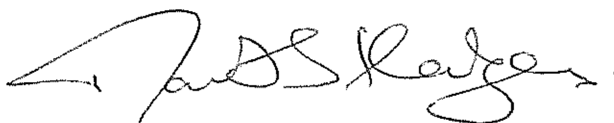
Nationwide Building Society including its subsidiaries and regional brands welcomes the opportunity to respond to CP40.

We are the UK's third largest mortgage lender, second largest High Street savings provider and seventh largest High Street financial services organisation, with around £200 billion in assets. As the UK's largest mutual building society, we are different from many of our competitors. Unlike firms that are run for the benefit of their shareholders and to maximise profit, we are owned by and run for the benefit of our 15 million members.

Our overall position in relation to the guidelines is one of support as measures which bring clarity to the securitisation markets by improving due diligence standards and remove any mis-alignment between the interests of originators or sponsors and investors, in particular, in the application of the retention requirement are to be welcomed. However, care must be taken to ensure that the guidelines do not impact on the viability of the securitisation market as a funding and capital management tool.

Our detailed responses to the specific questions raised are set out in the Appendix to this letter and take account of the fact that we have interests in both the asset and liability side of securitisation trades.

Yours faithfully



Mark Hedges
Head of Structured Finance

Nationwide Building Society is authorised and regulated by the Financial Services Authority under registration number 106078.
Credit facilities other than regulated mortgages are not regulated by the Financial Services Authority.
Nationwide Building Society, Nationwide House, Pipers Way, Swindon SN38 1NW.

D9T (02-2010)

APPENDIX

Question 1: Do you agree with this differentiation between the requirements of credit institutions when "investing" (leading to the applicability of Paragraphs 1, 4, and both sub-paragraphs of 5) as opposed to the lesser requirements when assuming "exposure" but not "investing" (leading to applicability of Paragraph 1 and sub-paragraph 2 of Paragraph 5)?

No.

There should be no differentiation arising from the type of exposure/investment – the driver should be whether or not the institution is capable of suffering a loss related to the securitised assets.

For example, if a liquidity provider or hedge provider is exposed to the credit risk of a securitisation position (i.e. they are deemed to be subject to Article 122a), they can suffer loss and should therefore be subject to the same requirements as investors.

Question 2: Do you agree with this differentiation in the role of a credit institution as liquidity facility provider (based on the provisions of CRD Annex IX, part 4, paragraph 2.4.1, point 13)?

Yes.

A liquidity provider that is not exposed to the risk of default of the underlying exposures should not be subject to Article 122a.

Question 3: Do you agree with this differentiation in the role of a credit institution as hedge counterparty, and what issues might arise when credit institutions seek to determine whether their role as hedge counterparty results in the assumption of credit risk or not?

Yes.

A derivative/hedge provider that does not assume risk arising from principal losses should not be subject to Article 122a.

Question 4: Does this guidance adequately address means of fulfilling the retention requirement in the case of securitisations of exposures from multiple originators, sponsors, or original lenders? And if not, what suggestions do you have for additional clarity?

In most circumstances the guidance adequately addresses the issues.

However, further guidance would be useful to clarify the application of the retention requirement when assets written by multiple originators are subsequently acquired and then securitised by the acquiring owner. In those circumstances, it should be clear that the retention requirement should be on that owner alone.

Question 5: Do you agree that the form of retention should not be able to be changed during the life of the transaction, except under exceptional circumstances only, or alternatively should some additional flexibility be granted? Please provide evidence of exceptional circumstances which would justify a change in the form of retention.

In certain structures there are arguments to support the contention that the form of retention should not be able to be changed throughout the life of the transaction, most obviously that this would make it more difficult for investors to ensure compliance.

However, if any change is adequately reported and subject to appropriate ratification, for example, by the trustee, we can see no reason why this should not be permitted. In the case of Master Trusts, a retention that was covered in changing proportions between minimum seller share and retained securities would be both effective and practical to monitor/report for investor comfort.

Question 6: Should the definition of "net economic interest" in terms of "nominal" exposure be interpreted to mean that both excess spread tranches (i.e. where only residual interest cashflows are sold) and interest-only tranches (i.e. where all interest cashflows are sold) be excluded from the various means of fulfilling the retention requirement (as both have notional rather than nominal values), or should either be a valid means of fulfilling the retention requirement? If the retention requirement were allowed to be fulfilled by retention of a tranche with no principal component (for instance, an excess spread tranche or an interest-only tranche), how would the retention percentage be computed – with reference to the notional value, market value, or otherwise?

In principle, there is no reason why some interest-only tranches shouldn't qualify towards an originator's net retained interest as these can represent a genuine economic interest. However, this really depends on whether the interest only tranche retained by an originator is truly impacted by adverse performance to the same degree as investors (i.e. will depend on position in the cash flow waterfall). The real issue is that, in practice, measuring the retention percentage attributable to such tranches would be difficult. Similarly, if an cash reserve to be grown through captured spread was disallowed as retention, it is difficult to argue that an excess spread tranche subordinate to it should be allowed.

Question 7: Where Paragraph 1 indicates that a credit institution must ensure that retention has been "explicitly disclosed", is the guidance above sufficient? In particular, will the market evolve such that credit institutions would expect such disclosure by market participants to be of a binding nature, and therefore provide some means of enforcement or redress to them, or should such a requirement be part of the CEBS guidance? Feedback is welcome on the most effective means to assure that the commitment of the originator, sponsor or original lender is enforceable by credit institutions that invest. This is an area which CEBS is likely to pay particular attention to in as part of keeping these guidelines up to date and in annual reviews of compliance.

From an investor point of view, it would be more favourable if the originator's disclosure requirements could be enforced by a regulator but it is not clear whether this is what is meant by "CEBS guidance". If the onus remains on investors to police this via the due diligence and ongoing monitoring process, there needs to some means of redress against the originator. Any form of legal action against an originator would be difficult to co-ordinate and would not be attractive for investors. The simplest solution would be some form of trigger built into the documentation. For master trusts the solution is already largely in place given that failure to maintain the minimum seller share breaches a non-asset trigger, penalising an originator by stopping substitution and prioritising payments to investors, effectively shutting off the trust for future issuance. The resultant subordination of the seller share will increase the

retention percentage over the run-off period . For standalone securitisations it is less clear what would be an appropriate penalty.

Question 8: Does this guidance address properly the subject of hedging of retained exposures? What specific types of hedge should be permitted? CEBS would welcome evidence and examples from respondents.

Yes. Macro hedges of the type illustrated would be acceptable. Further, any hedge which does not directly reference the assets should be permissible.

Question 9: Should retention of 5% of each securitised exposure fulfil the requirements of Paragraph 1 under option (a)?

Yes

Question 10: Should option (b) be applicable equally to both securitisations of revolving exposures and revolving securitisations of non-revolving exposures4 (or revolving securitisations with a combination of revolving and non-revolving exposures) in fulfilling the requirements of Paragraph 1?

Yes

Question 11: Do you agree with this interpretation of the phrase "there shall be no multiple applications of the retention requirement" to mean that there shall be no requirement for multiple application either by individual parties or at the level of individual SPVs, but that there may be multiple application at the overall transaction level (for instance, where a transaction is the resecuritisation of existing securitisations), and does the above lead to an effective and proportionate alignment of interest for resecuritisations?

Yes

Question 12: Does this interpretation of the phrase "net economic interest shall be determined by the notional value for off-balance sheet items" raise any potential issues with respect to application of the retention requirement?

There needs to be some flexibility around the inclusion of undrawn lending commitments. As an example, if a seller share in a master trust (that is representing the retention requirement) is dynamically sized to allow for draw capacity on flexible mortgages, this should be taken in to consideration.

Question 13: Given that Paragraph 1 specifies that "retained positions, interest or exposures are not hedged or sold", to what extent will it be possible for an originator, sponsor or original lender to use such retained interest for secured funding purposes without having "sold" such retained interest, for instance in cases where such funding is sought under a TBMA/ISMA Global Master Repurchase Agreement (GMRA) or alternatively under a bespoke repo agreement?

Repo of the retained interest should be permitted as this is for funding purposes rather than managing risk.

Question 14: Is further clarification needed on the ability to differentiate between the trading book and the non-trading book?

No

Question 15: Is the general guidance on securitisation stress testing in the document linked above sufficient, or is further guidance needed on how stress testing should be undertaken for the specific requirements of Article 122a, and if so what topics should such further guidance cover?

Further guidance on how stress testing should be undertaken for the specific requirements for Article 122a would be welcome. The proposed availability of cashflow models in future under SEC and Bank of England disclosure requirements should be referenced in the guidance.

Question 16: Do you agree with this method of calculating the additional risk weight?

Yes

Question 17: Do you have any comments on this approach to achieving consistent implementation of application of the additional risk weights by competent authorities, including both the level and duration for which additional risk weights are applied? Do you agree that, notwithstanding the textual provisions of Paragraph 5, the cumulative result of applying such additional risk weights should not result in the capital required to be held against a securitisation position exceeding the exposure value of such securitisation position?

Yes, it would not make any sense for the capital held against a securitisation position to exceed the exposure value.

Question 18: If a credit institution is involved as sponsor in the securitisation of exposures on behalf of third parties in an asset class or business line in which such sponsor is not itself active in extending credit, is the guidance provided above a sufficiently high standard to hold such sponsor to?

Additional guidance might be helpful – e.g. should a sponsor have to disclose the basis on which it has become comfortable with the original lenders credit criteria?

Question 19: Is this interpretation or the requirement with respect to "participations and underwritings in securitisation issues" clear and unambiguous, or are there alternative interpretations possible or clarifications necessary?

Yes

Question 20: Would disclosure templates that currently exist or are in the process of being prepared by trade associations, industry bodies, central banks, market participants or others fulfil these requirements on an adequate basis?

Standardised disclosure templates would be beneficial but should not prevent an investor from seeking additional information, where necessary.

Question 21: Would disclosure templates that currently exist or are in the process of being prepared by trade associations, industry bodies, central banks, market participants or others fulfil these requirements on an adequate basis?

Yes

Question 22: Would such implementation without a materiality threshold create complications or be overly burdensome?

No. The transitional period should be sufficient for originators, sponsors and issuers comply with the new requirements.