UK FINANCE

Reform of taxation of securitisation companies – Consultation Paper

Deadline Date: 3 June 2021
Lead Official: Taxation of Securitisation Companies Consultation Team, Financial Products and Services Team, HMRC
Sent to: Securitisations.Consultation@hmrc.gov.uk

UK Finance is the collective voice for the banking and finance industry.

Representing almost 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation. Our members include businesses that are large and small, international, national and regional, corporate and mutual, retail and wholesale.

General Comments

1. We welcome the opportunity to respond to the HM Treasury and HM Revenue & Customs ('HMRC') 'Reform of taxation of securitisation companies – Consultation' ('the Consultation').

2. UK Finance welcomes reform that would enable the securitisation regime to better serve market needs and, thereby, to assist the international competitiveness of the UK as a financial services centre.

3. We note that there is no specific mention of VAT in the Consultation and consider that it would be helpful for the government to take a holistic approach which includes VAT.

Specific Questions

Question 1: What are respondents' views on the commercial importance of retained securitisations, the drivers for such securitisations, and the impact of being able to carry out such securitisations in the UK on the competitiveness of the UK as a financial services centre?

4. Banks use retained securitisations to generate additional collateral for use in their businesses. Specifically, a retained securitisation enables a bank effectively to convert illiquid assets (e.g. a portfolio of corporate loans) into listed notes which are freely transferable and have an external credit rating. Such notes have a wide range of uses, including:

   - ***Raising external liquidity:*** Notes can be used as collateral in secured funding, or collateral exchange transactions

   - ***Accessing central bank liquidity:*** Some retained securitisations notes are eligible for use in Bank of England funding schemes[1], including those that support lending to the real economy (e.g. TFSME)

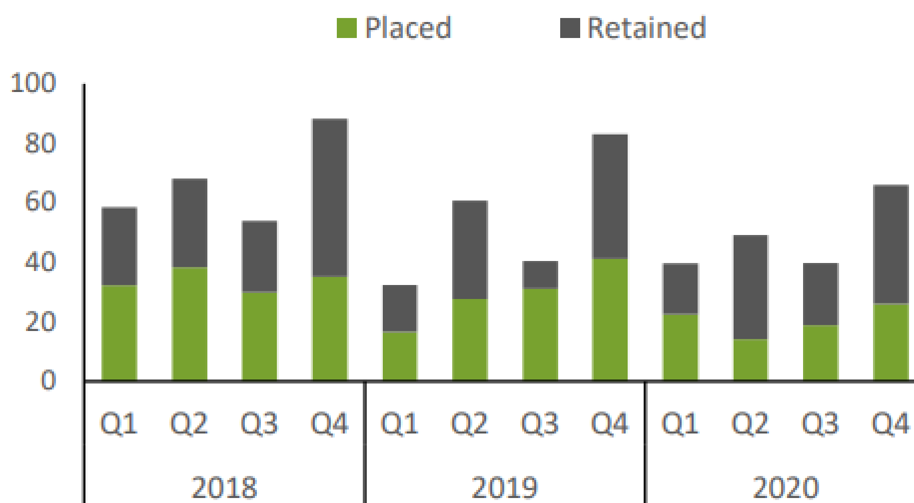
[1] *Retained securitisations are eligible as Level C Bank of England (see link to overview of Level C Collateral)*

- ***Collateralising other internal and external exposures:*** For example, guarantee or derivative positions

5. While banks could source collateral for these transactions externally (e.g. by sourcing government bonds or external securitisation positions in the market), this would be more expensive and may (depending upon how the collateral is sourced) consume additional capital resources (e.g. RWAs, leverage balance sheet). In contrast a bank does not need to hold any additional capital for retained securitisation notes, as all underlying assets are already fully capitalised by the respective bank.

6. Retained securitisations also provide banks with an important source of contingent liquidity; in a market stress it is much easier for a bank to raise funding by selling or upgrading a securitisation note, as compared to selling or upgrading the underlying raw loans. The collateral generated by retained securitisations accordingly contributes towards making banks safer and more resilient.

7. Retained securitisations are very common, not only in the UK, but also across Europe for the reasons described above. The European Central Bank also accepts retained securitisations as eligible collateral. In 2020 circa 60% (equating to c. €123bn) of newly issued European securitisation issuance was retained (source: Q4 2020 AFME report).



8. The main benefit of using a UK incorporated and tax resident company in a retained securitisation is that originators can benefit from the well-developed financial infrastructure in the UK: the issuing SPV is an independent entity with directors typically being provided by a UK trustee and documents drafted by UK legal counsel. If there were any uncertainty about the ability for a retained securitisation company to qualify for the UK securitisation regime, this would most likely result in a shift of retained securitisations to SPVs domiciled in other jurisdictions, such as Ireland, that have a well-established regime that ensures tax neutrality for securitisations.

Question 2: What changes by way of clarifying and/or reforming the Regulations in relation to retained securitisations would be helpful, and what form should they take? What would be the benefits and any potential difficulties of making any such changes?

9. Current market practice in using UK resident companies for retained securitisations reflects the position that, where a note issuing company is set up as a bankruptcy remote vehicle with the originator only ultimately involved in the transaction as owner of notes issued by the issuing company and/or as service provider, the note issuing company should fall within the Regulations as currently drafted. However, an amendment to, for example, Reg 2(3) of the Regulations to state explicitly that "loan creditor" includes an owner of any class of notes issued by a note issuing company would be very useful.

10. The requirement that notes are issued wholly or mainly to independent persons may present difficulties in structuring retained securitisations where for regulatory reasons (e.g. ringfencing) there is a requirement for members of a banking group to retain substantial equity ownership of the note issuing company. We would be happy to engage further with HMRC on this issue.

Question 3: Should the scope of assets which can be securitised within the Regulations be expanded beyond financial assets as defined in Regulation 9A? What would be the benefits and potential difficulties for the UK in doing so?

11. No comments.

Question 4: If the scope of assets were expanded, what assets should be included, and should that only be under specified circumstances? For instance, should shares be included but only as part of restructuring/ bailout of an existing securitisation?

12. It would be beneficial if assets were considered eligible where they were obtained as a consequence of a restructuring or bailout.

Question 5: If the scope of assets were expanded, what would be the implications for interaction with other parts of the UK tax code? What consequential changes, if any, would be appropriate?

13. No comments.

Question 6: Should the threshold limit per capital market arrangement be changed and if so, to what sum and why? Should the threshold be subject to any other amendment: for instance, should it be possible to take into account an issue made earlier in an accounting period in assessing whether the threshold is met for a second issue later in the period? If so, how and why?

14. UK Finance members have not seen evidence that the threshold limit is acting as a constraint but the ability to take into account other issuances either in the same accounting period or alternatively within a 12-month period could be beneficial to give flexibility.

Question 7: If any such changes are proposed, what would be the best way of minimising the risk that arrangements are inadvertently caught by the amended rules?

15. If the overall threshold were unchanged the risk would seem to be low.

Question 8: How and to what extent does uncertainty related to the applicability of the loan capital exemption on the transfer of notes issued in securitisation arrangements increase cost and complexity? To what extent is this a factor in securitisation arrangements being implemented outside the UK?

16. The use of a Partially Paid Note ("PPN") can in some circumstances be the preferred instrument to 'ramp up' the financing of an ISPV. A partly paid note is an instrument which is issued in an "up to" amount, not all of which is paid up on the initial issue date. One of the key features is a distinction between a "maximum principal amount" which is effectively an upper limit for the overall issue and an actual principal amount which is an amount subscribed and paid for by the noteholders.

17. The partly paid note can be issued in such form at the outset or restructured into such form from another instrument such as a fixed term note. The partly paid note is capable of being cleared through the clearing systems. It can exist as a separate instrument and can also be set up to exist alongside another, uncleared, instrument (an "uncleared PPN").

18. A PPN allows the securitisation vehicle to increase the financing up to a maximum amount without the need for new notes to be issued. There will also not be the need for a new supplemental trust deed, additional note purchase agreement or supplemental listing documents.

19. The applicability of the loan capital exemption to the use of a PPN is however currently uncertain, in particular due to the current exemption that if, at the time of the transfer the interest rate exceeds a reasonable commercial rate of return then the loan capital exemption will be switched off.

20. Upon each upsizing of the PPN, there is a risk that the interest rate set on the original issuance of the PPN will no longer be a reasonable commercial rate of return, hence SDRT may apply. This uncertainty can result in the clearing agent struggling to get comfortable on the use of PPN.

Question 9: What are the characteristics of notes issued in securitisation arrangements which create uncertainty as to whether the loan capital exemption applies to their transfer?

21. The most common characteristic is the question of whether the interest rate exceeds a normal commercial return at the time of the transfer.

Question 10: How could the government best address uncertainty about the applicability of the loan capital exemption to the transfer of notes issued in securitisation arrangements? Could updated HMRC guidance provide sufficient certainty?

22. It would be preferable to clarify through legislation rather than rely on guidance but if HMRC could issue specific guidance to clarify that the upsizing of a PPN should not impact the availability the loan capital exemption, similar to the guidance previously provided that they will not challenge new issues of debt (STSM041060), then this would be helpful.

Question 11: How and to what extent does uncertainty related to the applicability of the loan capital exemption for transfer of pools of loan assets into and within securitisation arrangements increase cost and complexity? To what extent is this a factor in securitisation arrangements being implemented outside the UK?

23. No comments.

Question 12: How could the government best address uncertainty related to the applicability of the loan capital exemption to the transfer of pools of loan assets into and within securitisation arrangements? Could updated HMRC guidance provide sufficient certainty? If an exemption is required should there be a value cap on the individual assets and what should that cap be?

24. No comments.

Question 13: What are the characteristics of notes issued by ISPVs which create uncertainty as to whether the loan capital exemption applies to their transfer? How and to what extent does uncertainty related to the applicability of the loan capital exemption to transfers of such notes impact commercially on ILS arrangements?

25. No comments.

Question 14: How could the government best address uncertainty related to the applicability of the loan capital exemption to the transfer of notes issued by ISPV companies? Could updated HMRC guidance provide sufficient certainty?

26. No comments.

If you have any questions relating to this response, please contact Sarah Wulff-Cochrane, Principal, Taxation Policy, UK Finance (sarah.wulff-cochrane@ukfinance.org.uk).