
Asset Backed Capital Markets Funding Alternatives at HBOS

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HBOS Treasury Services

UK ALMA Conference
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HBOS plc - financial services group

HBOS plc is a diversified financial services company providing predominantly retail services, corporate banking and business banking in the United Kingdom

- **Active in the fields of mortgages, personal loans, business loans and financing, long-term savings, consumer credit, insurance, liquidity and risk management and the sale of treasury products**
- **Seventh largest European financial institution by market capitalisation**
- **No 1 UK mortgage market share of 17%***
- **No 1 UK savings market share of 15.9%***

* as at 31 December 2004

	June 2005	UK ALMA Conference	
	1		

HBOS plc financial highlights

- **Market capitalisation in excess of £33.3 billion***
- **Total assets: £443 billion***
- **Shareholders' equity: £20.6 billion***
- **Profits before tax & exceptional items: £4.77 billion***

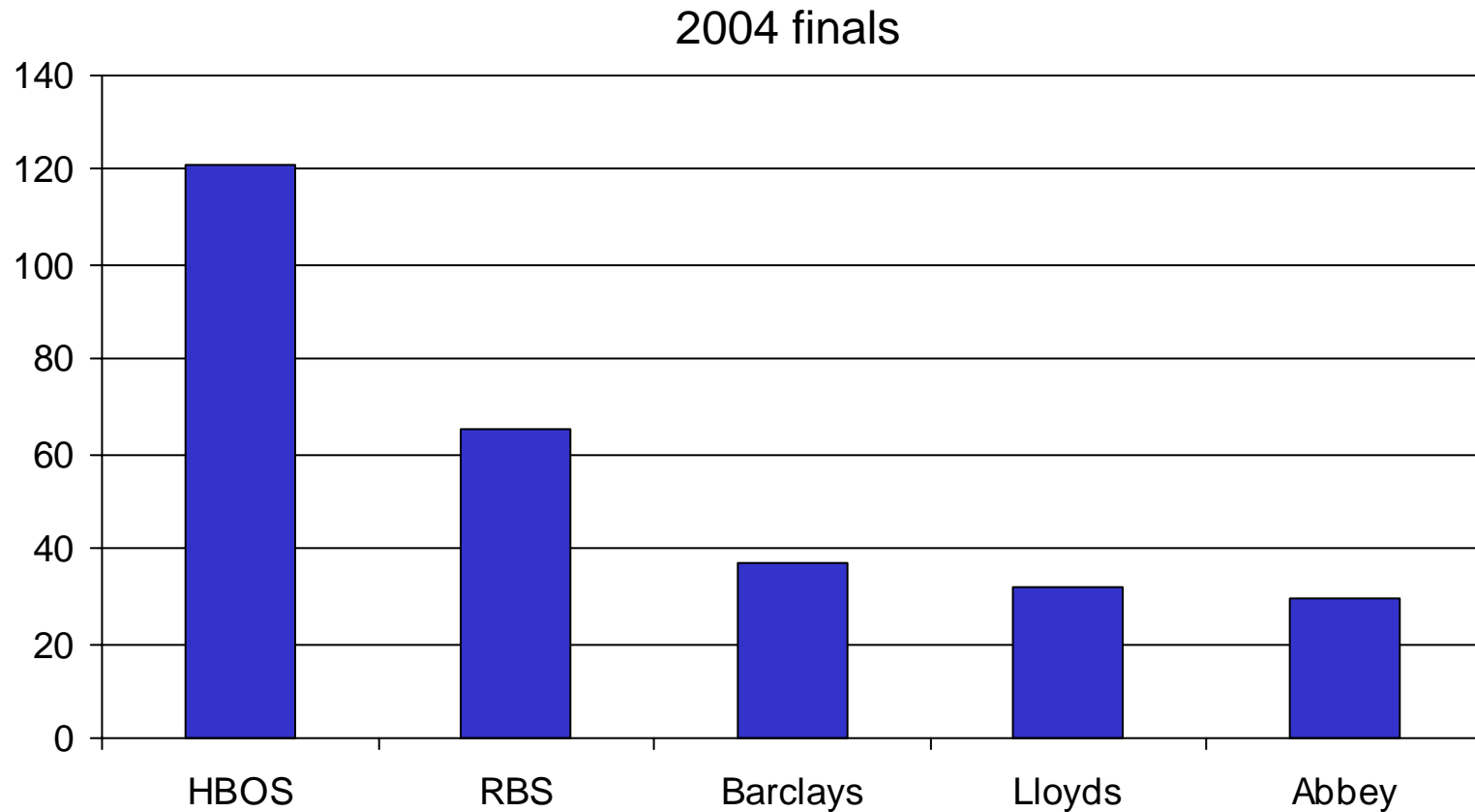
HBOS credit ratings

	Moody's		S&P		Fitch	
	Short term	Long term	Short term	Long term	Short term	Long term
HBOS Treasury Services	P-1	Aa2	A-1+	AA	F1+	AA+
HBOS plc	P-1	Aa2	A-1+	AA-	F1+	AA
Bank of Scotland	P-1	Aa2	A-1+	AA	F1+	AA+
Halifax plc	P-1	Aa2	A-1+	AA	F1+	AA+

* as at 31 December 2004

Customer funding gap (£bn)

Loans and advances to customers less than deposits



HBOS – A distinct asset-backed issuer

Top 5 UK Clearing Banks

(by assets 2004 €'bn)

Rank	Group	Value
1	HSBC	1,277
2	RBS	583
3	Barclays	522
4	HBOS	443
5	Lloyds	225

Top 5 Structured Finance Issuers*

(by value 2004 €'bn)

Rank	Group	Value
1	HBOS	24.63
2	Northern Rock	17.47
3	Abbey National	5.99
4	GMAC-RFC	4.12
5	Bradford & Bingley	2.00

* Source: ISR

HBOS term asset-backed finance programmes

Programme	Start Date	Asset Class	Outstanding debt
Mound	2000	UK Residential Mortgages (Self-cert and BtL)	£3.3 billion
Melrose	2001	Loans to UK mid cap corporates	£2.25 billion
Permanent	2002	Prime UK residential Mortgages	£26.7 billion
UK Structured Covered Bond	2003	Prime UK Residential Mortgages	£8.6 billion
UK Structured Covered Bond	2004	Social Housing Loans	£1.0 billion
Candide	2005	Prime Dutch Residential Mortgages	£1.0 billion

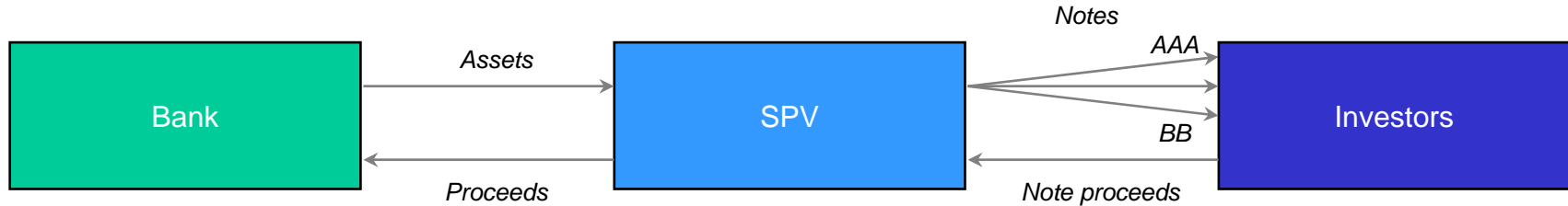
- **New programmes for 2005-2006**

- CMBS
- auto loans
- credit cards
- specialist mortgages

Funded vs. Synthetic Securitisations

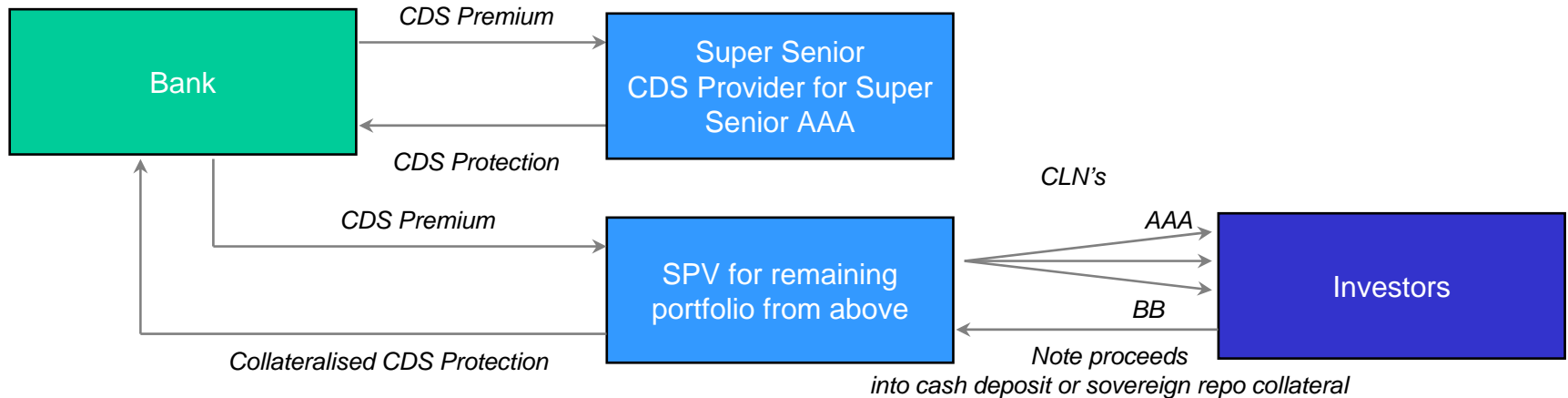
Funded

True sale of assets



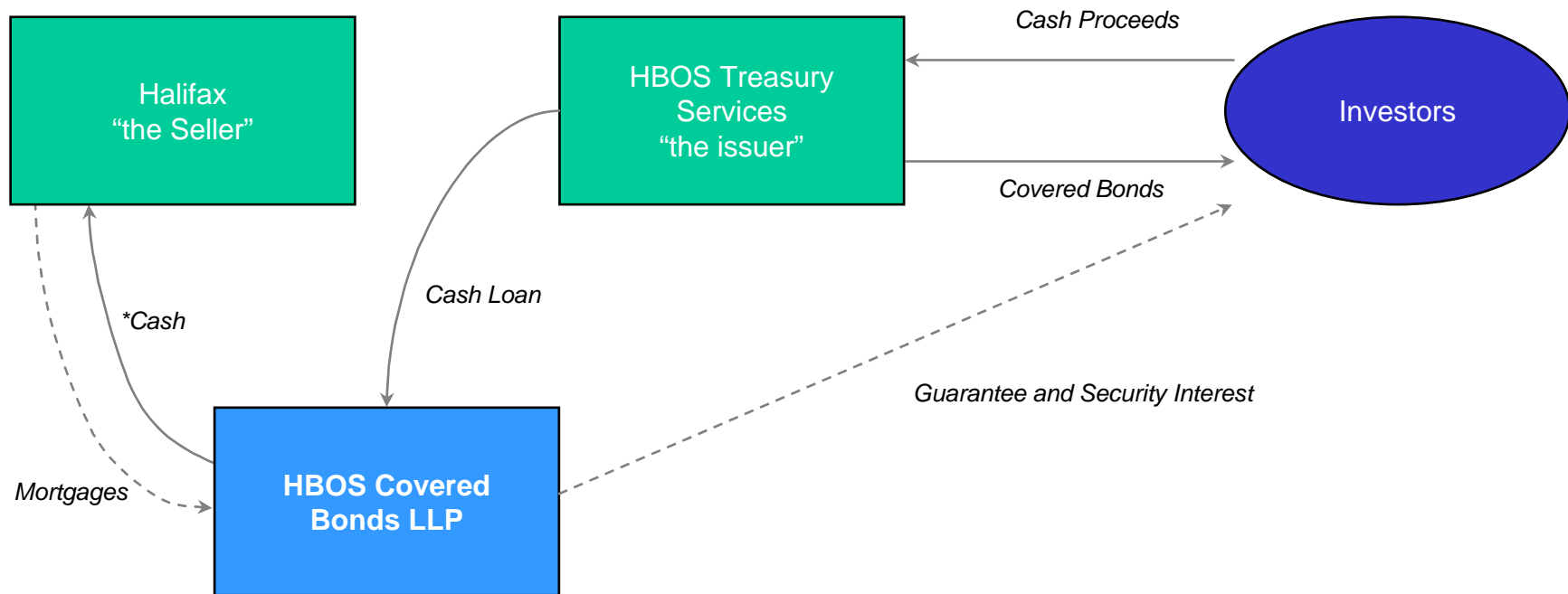
Synthetic

No true sale of assets



	Funding	Capital Relief
Traditional Funded Securitisation	◀	◀
Synthetic Securitisation	⚡	◀

UK Covered Bond structure



**includes Capital Contribution + Deferred Consideration*

The capital contribution represents the amount of over-collateralisation contributed by Halifax for the benefit of investors

HBOS Treasury Services issues Covered Bonds and is legally obliged to pay interest and principal. The LLP guarantees the Covered Bonds and grants a security interest over its assets in favour of investors.

Asset-backed funding objectives for HBOS

Pre-Basle II

- Primary - funding
 - diversification
 - lengthening the maturity profile
 - cheaper (if taking into account the regulatory capital benefits)
- Secondary - regulatory capital relief (securitisations only)
 - Do synthetics make sense in this market?

Post-Basle II

- Primary - funding
 - will we issue securitisation sub-AAA?
 - where will our AAA RMBS price
- Potential regulatory capital relief on lower quality assets
- Transactions for management of economic capital

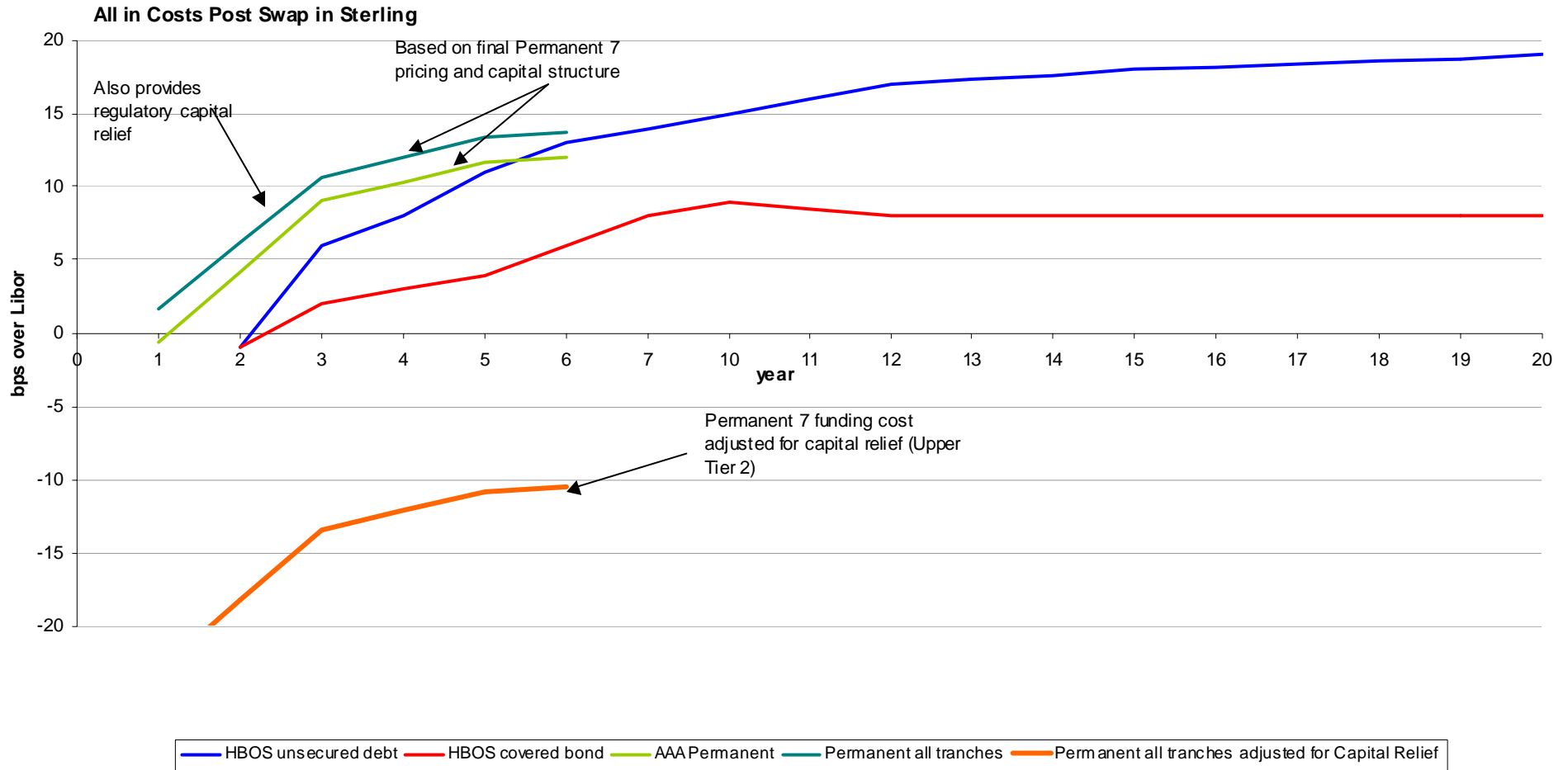
Securitisation vs. Covered Bonds

	Securitisation	Covered Bonds
Diversification from unsecured debt investor base	✓ ✓	✓ ✓
Large issuance amounts	✓ ✓	✓
Lengthens the maturity profile	✓	✓ ✓
Liquid instrument	✓	✓ ✓
Cheaper funding	✓	✓
Ease of execution	✗	✓
Capital relief	✓	✗ (could be increased)

And regulatory issues....

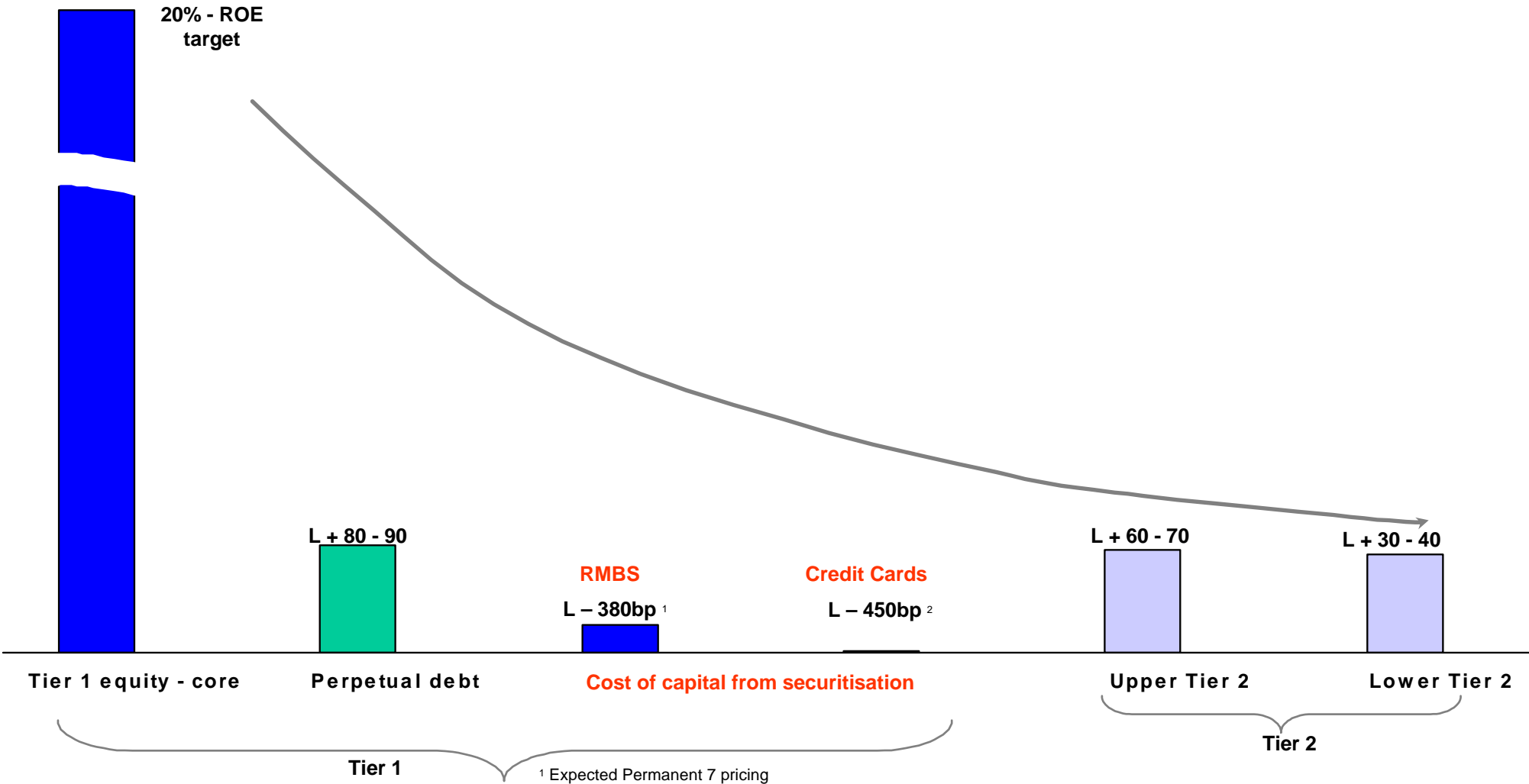
HBOS funding perspective

Snap Shot of Projected Current Debt Issuance Pricing as of 18/03/05



HBOS capital perspective

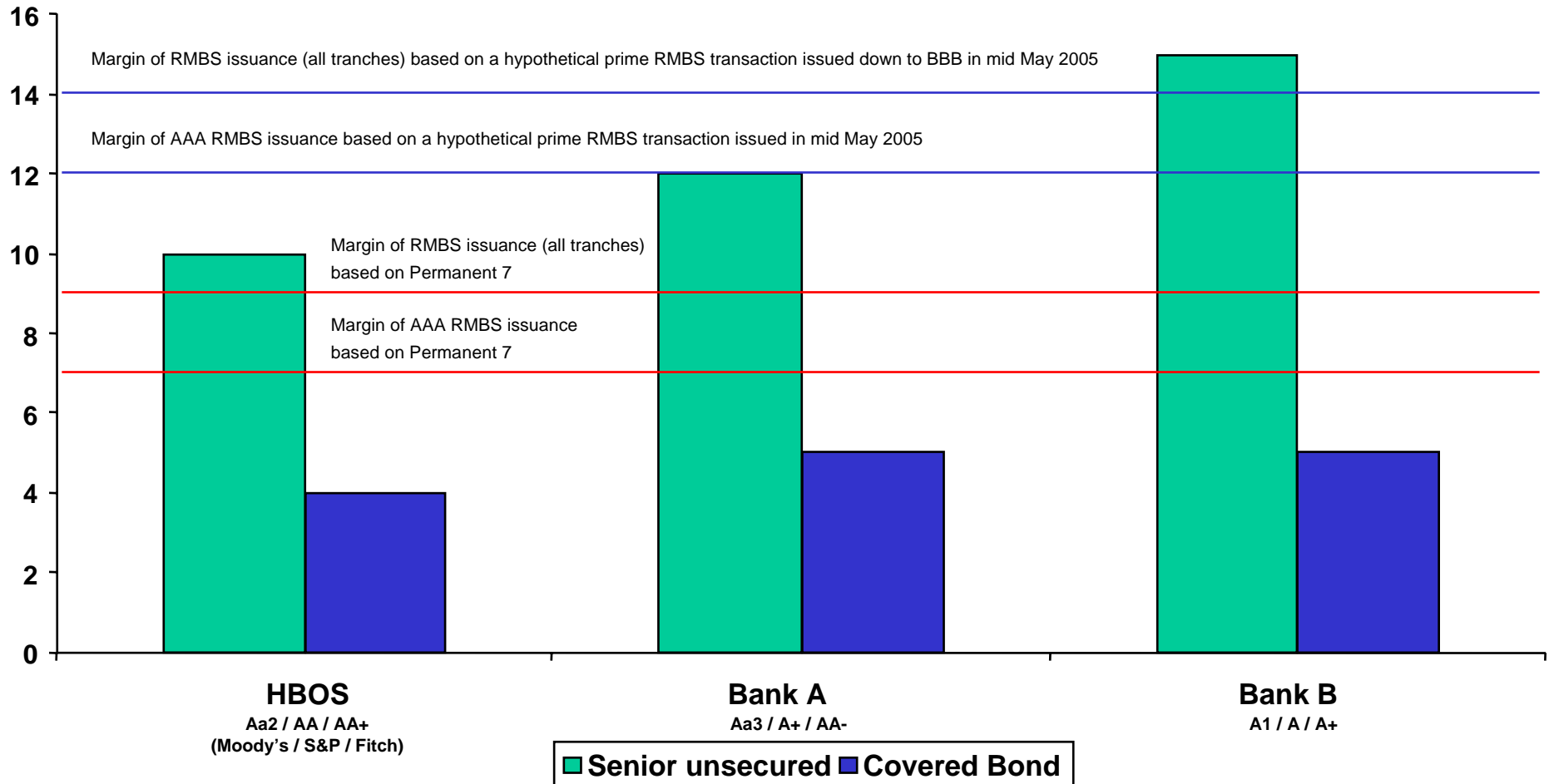
Estimated cost of capital issuance



¹ Expected Permanent 7 pricing
² Based on hypothetical Credit Card transaction

What's the forecast for the future

Estimated costs on 5-year debt

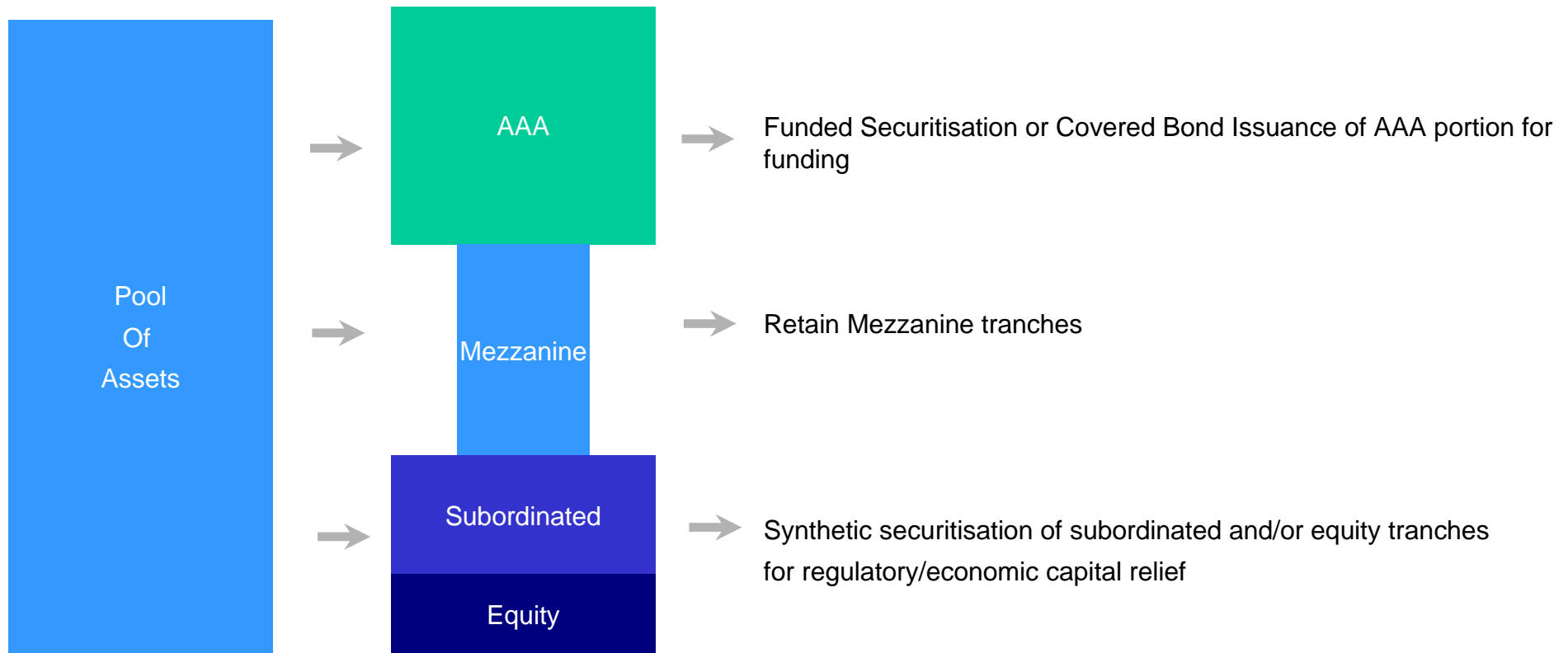


The Future – more of the same or changes in strategy

- Depends on the objectives/needs of each issuer
- General conclusions
 - Securitisation will not provide regulatory capital relief on prime RMBS portfolios
 - Synthetic, regulatory capital relief transactions will disappear in respect of many asset classes unless there is a desire to cap regulatory capital volatility
 - Securitisations for funding purposes should continue but fully funded structures down to BBB and below will only be attractive to institutions that are lower rated and have limited sources of AAA funding
 - Regulatory concerns may place some limits on covered bond issuance

Possible changes to asset-backed funding/risk management

- In the future, a barbell approach may be more apt for some issuers – a mixture of funded and synthetic securitisation



Examples of the move to the future

- Efficient funding
 - Granite MTN programme
- Slicing/Dicing the same portfolio
 - Northern Rock
 - › Covered Bonds
 - › Provide Graphite 05-1 synthetic RMBS
- Egg
 - Provide Release 03-1 synthetic RMBS
 - Cronos RMBS 2005 – AAA only funding
- Economic Capital Management through synthetic transactions
 - ING
 - › MARS – SME CLO
 - › Memphis I & II – prime Dutch RMBS

Regulatory issues concerning Covered Bonds

- Last year, the industry began discussions with the FSA, in a effort to get Covered Bonds recognised in the regulatory framework.

Discussion topics with FSA – Issuance Limitations

- Liquidity benefits of covered bonds
 - Additional benefits recognised by the FSA
- Gearing effect on unsecured depositors through covered bond issuance
 - Loss given default increases marginally for unsecured creditors
 - Extent of market downturn required before unsecured borrowers are adversely affected by one notch downgrade
 - › Nearly 15 times historically high loss rates would need to occur before depositors are adversely affected by covered bond issuance
 - › Loss severity only increases in situations that have yet to occur
- Availability of capital supporting the mortgage portfolio supporting the covered bond
 - FSA have indicated that at no time must there be any restrictions on a decision to sell an asset in order to release capital and improve solvency if the capital supporting the asset is to be considered Tier 1 capital
 - Covered bond programmes must not prevent the sale of mortgages from, and cash collateralisation of, the covered bond structure

Regulatory issues concerning Covered Bonds (cont.)

Discussion Topics with FSA – risk weighting of UK covered bonds

UK covered bonds are currently not eligible for a 10% risk weighting and are weighted at 20% as bank debt

- To address this it is necessary for the issuer to be subject by law to special supervision designed to protect bondholders (currently not the case in the UK) as required by the UCITS directive
 - Who is the competent authority – Parliament or FSA? Appears it will be the FSA
 - The definition of a covered bond should be limited to the minimum required to qualify under Article 22 of the UCITS directive
- The draft EU Directive of July 2004 (EU Commission proposal for Directives on the Re-casting Directive 2000/12/EC and Council Directive 93/6/EEC on the capital adequacy on investment firms and credit institutions) provides a definition of Eligible Assets for covered bonds.
 - requires redrafting in a number of places if it is to capture UK structured covered bonds
- Recent conversations with the FSA suggest a satisfactory outcome may be achievable
- How important is the regulatory risk weighting in a Basle II world?

Thoughts for the future

- Not all issuers are the same – their future asset-backed issuance strategy will depend on a number of market factors and factors individual to the issuer (e.g. comparative cost to unsecured debt, availability of assets for AAA funding etc.)
- Most major major takers of wholesale funds from the asset-backed capital markets will continue to rely on both securitisation and covered bonds issuance
- Covered bonds and securitisation will continue to be complementary funding strategies with each accessing different investor bases although a cross over is occurring
- Securitisation of prime residential mortgages will no longer provide capital relief and this will mean these types of securitisations will essentially become funding exercises.
- Securitisation for capital purposes will become more of an economic capital management exercise

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