Evolution of Programmatic RMBS Structures

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This note looks at the evolution of traditional residential mortgage-backed securitisation structures for programmatic issuance in the UK market.

The desire for innovation is a valuable human trait that becomes even more pertinent when there is a pressing need for it. An area where innovation has been looking increasingly relevant is the financing of residential mortgage loans in the UK because of (a) the wall of refinancings facing us due to the tapering of quantitative easing from the Bank of England (especially with the maturity of the Term Funding SME (TFSME) scheme), and (b) the increased costs pressure in a high inflationary and high interest rate environment.

Owners of mortgage loan assets have so far used two main types of funding structures for accessing the public markets (a) standalone residential mortgage-backed securitisations (RMBS) and (b) traditional master trust structures (leaving aside, for current purposes, covered bonds). Both structures have their relative merits and limitations and appeal to different types of borrowers for different reasons. However, a new type of "master" structure was developed in 2020 by Coventry Building Society and their advisers (the Economic Master Issuer PLC RMBS programme (the "EMI Structure")), that sits somewhere in between the two traditional types of structures in terms of its characteristics.

Key points

- Newer style master issuer structures have a less complex SPV structure and can create cost and time savings for issuers.
- Advantages of the master issuer approach include: more efficient use of collateral, more flexible trigger events, cures and principal allocation rules, shorter lead time to issuance, a more streamlined corporate structure with fewer documents and SPVs and more modern features such as negative consent and electronic voting.
- However, master trust/master issuer structures are not suitable for everyone, for example those who (i) issue less frequently or less regularly, (ii) might want to finance their static risk retention positions, (iii) would prefer simpler to establish and simpler to manage transactions or (iv) want to trade away portfolios of loans and are not interested in maintaining a living and breathing funding programme.

The adoption of this type of structure was made possible because of changes in tax regulations in England. We understand that Coventry Building Society remains the only borrower to have issued under the EMI Structure; although, given the current macro environment, there is renewed interest from issuers in exploring the full range of mortgage financing options.

Some banks and building societies, having established master trust programmes pre-global financial crisis, have worked to modernise them via *ad hoc* amendments where required, and have continued to issue (more or less) regularly under those programmes (with many of them relying on Bank of England funding schemes for most of their funding needs). Others have relied on standalone RMBS structures. The EMI Structure is now gaining popularity and it appears that there may be increased adoption of that option.

Traditional master trust structures and newer style master issuer structure

"Master" structures typically make sense where owners of mortgage loans expect to access the public capital markets at least two or three times a year because those programmes (in particular, traditional master trust structures) are (i) expensive to set up and maintain (especially if modifications are required to be made through consent solicitation exercises), (ii) complex in their documentation, cashflows, trust arrangements, tax treatment, and enforcement mechanics. Also, most of the traditional master trust structures were established before the 2008 global financial crisis, so do not contain a number of the modern features that have been included in structures since then to make them more agile and efficient.

The newer style master issuer structure is less complex and less expensive compared to the traditional master trust structure, because it does away with the multiple levels of SPVs, and assets are all owned by a single issuer SPV. These structures also allow for more efficient use of collateral due to the possibility of subordinating the seller's note (not provided for in older master trust programmes where a bare trust structure is employed) in addition to the seller's note being used to cover dilution risk and for risk retention purposes. The seller note and revolving series can also share principal with series in pay-down to make amortisation or accumulation more efficient. There is also greater flexibility to remove over-collateralisation, by way of repaying the seller note, which also adds to the efficiency of the structure. In addition, the EMI Structure provides for a more flexible approach to trigger events, cures and principal allocation rules. This updated structure still provides the same benefits that traditional master trust structures provide, such as (i) programmatic issuance and a shorter lead time to issuance (making it easier for issuers to respond to reverse-enquiries or to issue on a condensed timeframe where market conditions are favourable), (ii) a "socialist" structure with a revolving pool of eligible assets, (iii) the ability to issue multiple series of notes with different characteristics in terms of principal amounts, issuance price, interest rates, maturity dates, redemption profits, currencies, and target market (Regulation S versus Rule 144A). Other advantages include closer proximity of secured creditors to the charged assets (as is the case in standalone RMBS transactions), more modern structural features in relation to modification rights, negative consent and electronic voting, and more flexible asset and non-asset triggers, including in respect of cures.

These structures may not be suitable for everyone, for example those who (i) are unlikely to tap the public markets more than once or twice in a typical year or those not intending to originate sufficient volumes of loans to generate the level of collections required to service the relevant interest and principal payments under a programmatic structure (including potentially in respect of scheduled or bullet amortisation notes), (ii) want to maintain "capitalist" structures and static pools of assets that pay out largely on a passthrough basis (iii) want to structure a simpler to understand deal which is also simpler to manage (and which requires little or no active management in order to maximise collateral efficiencies), (iv) wish to finance their static risk retention positions, and/or (v) wish to give external junior investors the ability to acquire the portfolio of mortgage loans on or after the optional redemption date (or margin step-up date), a tool used typically for portfolios expected to be traded away by the original owner of the portfolio. For banks and building societies for whom a programmatic structure does fit the bill, however, the innovative approach seen in the EMI Structure, is likely to be an attractive one.

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