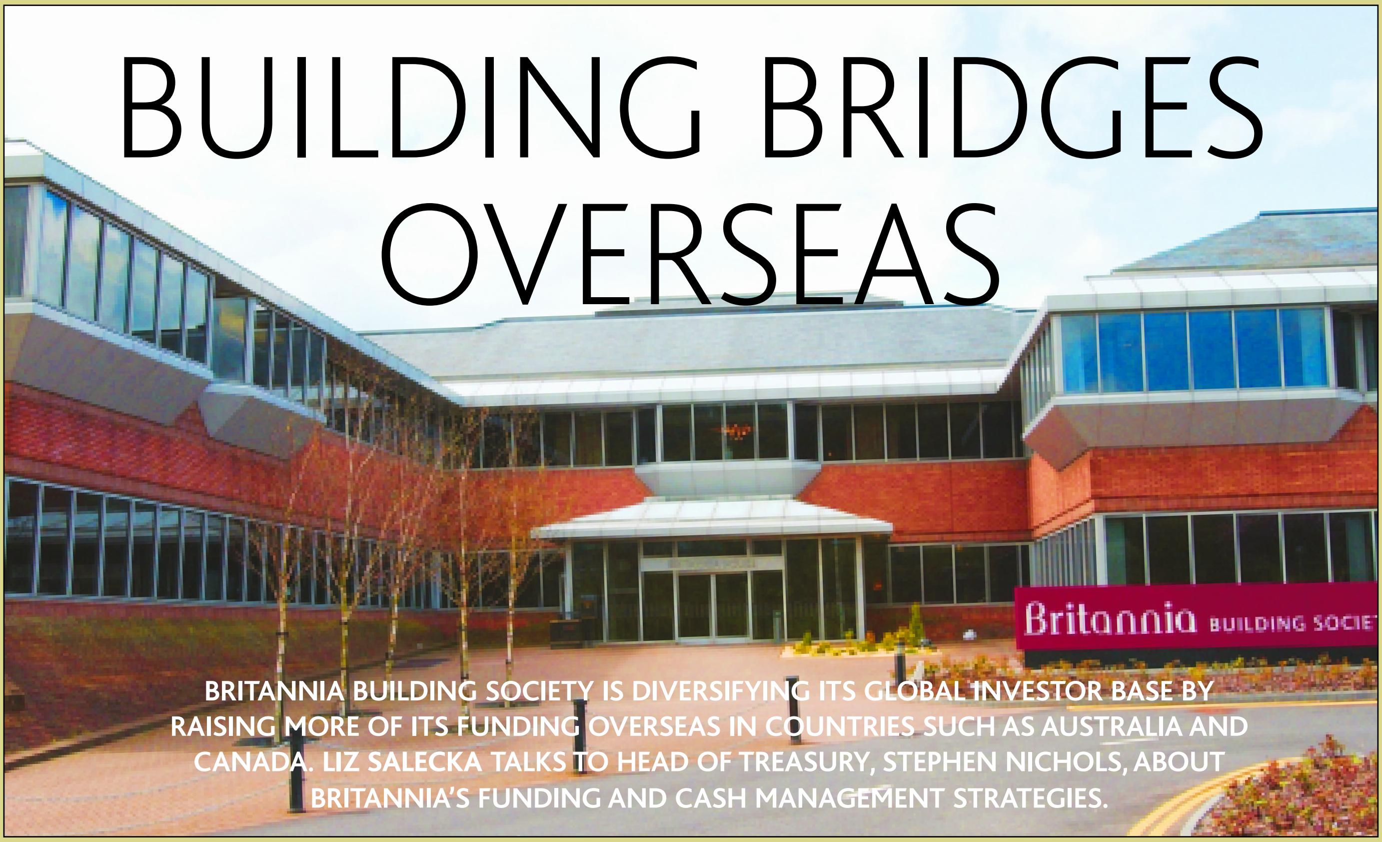

BUILDING BRIDGES OVERSEAS

BRITANNIA BUILDING SOCIETY IS DIVERSIFYING ITS GLOBAL INVESTOR BASE BY RAISING MORE OF ITS FUNDING OVERSEAS IN COUNTRIES SUCH AS AUSTRALIA AND CANADA. LIZ SALECKA TALKS TO HEAD OF TREASURY, STEPHEN NICHOLS, ABOUT BRITANNIA'S FUNDING AND CASH MANAGEMENT STRATEGIES.

Britannia is the UK's second largest building society and the nation's 12th largest mortgage lender, with £15.4bn of mortgage assets and £11.1bn of retail savings balances under management.

It is a mutual organisation with a national network of 188 branches. Its treasury operation is a 20-strong team based at the group's head office in Leek, Staffordshire.

Head of Treasury is Stephen Nichols, whose team is responsible for £5.5bn of liquid assets, the arrangement of £7bn of wholesale funding and balance sheet management of £22bn in assets and liabilities to reduce volatility and maximise returns.

NEED FOR DIVERSIFIED FUNDING. For Britannia, the central treasury plays a vital role in the arrangement of long-term finance for mortgage lending, as well as short-term borrowings to support the business and lending activities.

The group strategy is to achieve as much diversity in its borrowings as possible, with the retail (58%), wholesale (37%) and offshore markets (5%) all tapped by the building society. Securitisation and warehousing are utilised to support lending by Platform, a specialist mortgage lending company, which is part of the wider Britannia Group.

Executive summary

- Britannia's treasury team is responsible for £5.5bn of liquid assets, £7bn of wholesale funding and the balance sheet management of £22bn in assets and liabilities.
- Britannia's credit status ensures attractive pricing in overseas markets such as the US, Canada, France and Australia.
- Its money markets team enters up to £500m of transactions per day. Cash from Britannia's branches is pooled in and out of the main bank account and is managed by the treasury team.
- The treasury team focuses heavily on asset and liability management (ALM), managing exposures to adverse movements in interest rates. The balance sheet is divided into four books to reflect underlying interest rate exposures.
- Britannia Treasury Services, a separate company in the group, has raised more than £2.5bn through securitisation since 1997.

The competition in the UK's financial services marketplace for savings is pushing rates up, and placing pressure on margins. This makes the wholesale markets an attractive option when financing lending.

Nichols says: "Wholesale funding is now cheaper than retail and we are using this market for both cost-efficiency and to attract new investors and maximise our flexibility."

The society's wholesale funding has increased in recent years to 37% of total borrowing – although this is still well within the legal requirement of below 50% of total borrowing.

WHOLESALE MARKETS STRATEGY. On average, Britannia raises £1-1.5bn of new finance every year in the long and short-term wholesale markets. Nichols says the central treasury's key objective is to diversify its sources of funding in terms of investor base. In addition to the strong reputation of the building society sector in the UK, the society's A credit rating with Standard & Poor's (A2 with Moody's and A+ with Fitch) has ensured attractive pricing in overseas markets. This route continues to be actively pursued.

"This provides us with greater diversity when it comes to arranging funding and allows for much greater flexibility. The UK market has a finite number of investors," says

Nichols. "We have also been able to tap overseas markets at a low cost as a result of our credit rating."

For long-term funding, the building society has relied on a US$4.5bn euro medium-term note programme since 1993, which is reviewed every year and rolled forward. So far this year, the programme has raised £200m through a floating rate note issue, £200m of subordinated debt (for capital purposes) and £200m through private placements.

With US$4bn of the programme utilised, Britannia is looking to extend it to US$6.5bn this year, and plans a benchmark euro issue as its next long-term financing activity later this year. In 2007, the Asian market and US domestic market are also likely to be tapped.

Meanwhile, short-term funding is raised in sterling in the domestic market by issuing certificates of deposits and borrowing time deposits with tenors ranging from overnight to one year. The movement towards a more globally-diversified investor base is accentuated by a US$2bn global commercial paper programme, C$500m Canadian commercial paper programme; €2bn French commercial paper programme; and a A$1bn Australian debt issuance programme.

MANAGING BRANCH CASH NEEDS. Managing the building society's cashflows is another vital aspect of the group's central treasury, whose specialist money markets team enters up to £500m of transactions on a daily basis.

Daily requests for cash, and the cash surpluses of Britannia's branches, are individually handled by the society's financial operations, but this money is pooled out of, and into, a main bank account managed by the treasury operation.

The treasury relies on historical data when forecasting its branches' daily, weekly and monthly cash requirements, and is always notified of large transactions in advance. It also can depend on a number of banking support lines and other tools for fast access to cash.

Britannia holds 25% of its assets in liquid form – well above the legal minimum requirement. Of this, 20% is prudential liquidity that is invested in marketable instruments; 6% of the latter is short-term liquidity of up to eight days. The majority of the building society's liquid assets take the form of lending to banks, other building societies and local authorities. It invests in bank deposits, certificates of deposit, floating rate notes, mortgage-backed securities, repos and commercial paper, as well as the overnight bank deposit market.

ASSET AND LIABILITY MANAGEMENT. Another of the central treasury's key roles is asset and liability management (ALM) to reduce volatility and ensure the best returns possible. As well as looking after £1.4bn of the group's reserves, the central treasury's main focus is to manage exposures to adverse movements in interest rates.

In order to understand, measure and manage such risks, the society's balance sheet is divided into four books that reflect the underlying interest rate exposures:

- **Administered book** – standard variable rate loans funded by traditional savings.
- **Libor book** – shorter-term liabilities and assets that are exposed to movements in short-term money market rates.
- **Fixed book** – long-term fixed-rate mortgages funded by fixed-rate liabilities such as gilts. This book is exposed to a rise in interest rates that would increase the cost of borrowing for the society without increasing revenues from lending. The society would have to pay more in interest to fund its existing fixed-rate loans.
- **Basis book** – Libor related assets funded by administered rate liabilities.

Stephen Scott Nichols, Head of Treasury, Britannia

Stephen Scott Nichols has been with Britannia since 1987, having joined as Assistant Treasurer (Liquidity) before moving on to become Deputy Treasurer (1991-2001) and then Head of Treasury Operations.

Prior to joining Britannia, he worked for Whiteway Laidlaw & Co Ltd, the banking subsidiary of Great Universal, which he joined as Head of Foreign Department in 1976 before moving through successive roles to become Operations Manager in 1986.

Stephen is a member of the Association of Corporate Treasurers, an associate of the Chartered Institute of Bankers and an associate of the Institute of Chartered Secretaries.

'ASIDE FROM LOOKING AFTER £1.4BN OF THE GROUP'S RESERVES, CENTRAL TREASURY'S MAIN FOCUS IS TO MANAGE EXPOSURES TO ADVERSE MOVEMENTS IN INTEREST RATES'

Having ascertained where the greatest risks are, the central treasury monitors the four books on a daily basis, conducts daily mark to market valuations and measures the potential risks using gap, duration and sensitivity analysis. It then uses short and long-term off balance sheet instruments such as swaps and forward rate agreements to manage these exposures.

SECURITISATION. Although central treasury looks after the funding and cash management requirements of the building society, it is not the organisation's sole funding operation.

The group also comprises Britannia Capital Investment Group (BCIG), a group of profit-generating companies, including Britannia Treasury Services (BTS), which is managed separately from the society's treasury operation.

BTS is involved in the purchase and sale of mortgage portfolios, the management of investments and the securitisation of mortgage portfolios. It has raised over £2.5bn through securitisation since 1997.

The securitisation of mortgages for Platform – another BCIG company that specialises in high risk non-conforming mortgages, sub-prime lending, buy-to-let and self-certification mortgages – is one of BTS' key activities. Platform usually has about £1.5-£2bn of lending on its books, much of which is securitised.

"Mortgages lent by Platform were always securitised prior to us purchasing the company in 2001," says Nichols. "Securitisation diversifies our channels of funding and mitigates the risk represented by the assets. It takes relatively higher-risk mortgages off balance sheet and this has supported our capital ratios and credit ratings."

BTS warehouses the mortgages that are lent by Platform and other third parties in a Special Purpose Vehicle (SPV) until they reach a total value of £500m-£1.bn, and then securitises them. Such asset sales take place about twice a year. The last deal in March 2004 was for approximately £700m of bonds, issued in sterling, US dollars and euros.