

THE EU SECURITISATION REGULATION – ENTERING A BRAVE NEW WORLD¹

On 1 January 2019 the EU Securitisation Regulation (the "**Regulation**" or "**Securitisation Regulation**") began to apply – somewhat extraordinarily – before key elements of the regime were even close to being finished. Of the dozens of mandates for technical standards and guidelines, not a single one has been completed and published in the Official Journal of the European Union.

In this briefing, we provide an overview of the Regulation and set out some of the practical compliance challenges that result from needing to comply with a new and still incomplete regime.

As a refresher, the Securitisation Regulation - which will in general apply only to securitisations² issued on or after 1 January 2019 - will do two main things:

- repeal the main securitisation provisions in existing sectoral legislation applicable to banks (the Capital Requirements Regulation, or "**CRR**"), insurers (Solvency II) and fund managers (the Alternative Investment Fund Managers Directive regime) and recast those provisions in a new, harmonised securitisation regime applicable to all institutional investors including UCITS and pension funds; and
- introduce a concept of "simple, transparent and standardised" (or "**STS**") securitisation that receive more benign regulatory treatment than other securitisations.

In addition to these two high-level changes, the Securitisation Regulation legislative package introduced a number of other significant changes. These include a ban on resecuritisation, a ban on securitising self-certified residential mortgage loans originated after 21 March 2014 and formal restrictions on marketing securitisations to retail investors.

We consider the main elements of the Regulation in more detail below. The amendments to the CRR which accompanied the Securitisation Regulation are beyond the scope of this briefing.

RECAST SECURITISATION REGIME

The first thing the Securitisation Regulation does is to recast the main regulatory obligations associated with securitisation. Perhaps the most significant change, though, is not in the substantive content of these obligations, but in their vastly expanded scope. By virtue of the fact that securitisation rules have hitherto been part of the prudential regulation of banks, fund managers and insurers, only those regulated institutions have had to consider compliance. The

Key issues

- The regulation of securitisation in the EU has just been completely overhauled, effective 1 January 2019
- That overhaul includes bringing into regulation a large number of entities who were previously unregulated
- The regime is not yet complete, leading to a high degree of compliance uncertainty
- This uncertainty is likely to persist for at least several more months, requiring a pragmatic approach to keep markets operating in the interim

¹ This briefing largely reproduces and updates content we previously published as part of "[The New Spring for Securitisation](#)" in May 2018.

² This refers to securitisations for EU regulatory purposes, being a "transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures is tranching, having all of the following characteristics:

(a) payments in the transaction or scheme are dependent upon the performance of the exposure or of the pool of exposures;
(b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme;
(c) the transaction or scheme does not create [specialised lending exposures as defined] in Article 147(8) of Regulation (EU) 575/2013."

reach of EU securitisation rules has historically further been limited because they have largely been structured as rules on investors, so even an EU bank could escape most EU securitisation rules by marketing its transaction exclusively to non-EU investors. A large EU corporate securitising its trade receivables with either unregulated or non-EU investors would – until 1 January 2019 – have been subject to essentially no EU regulation aimed at securitisation.

All of this has just changed. Under the Securitisation Regulation, any originator, sponsor³, original lender or issuer involved in a securitisation⁴ will be subject to a raft of obligations regardless of their status as regulated entities or otherwise. This is made more onerous by the fact that many transactions have multiple parties who could fulfil at least one limb of the defined term "originator" and the uncertain scope of which "originators" will be considered caught by these obligations. The obligations include a direct risk retention obligation and extensive disclosure obligations (discussed further below). Even though this expanded scope of regulation has been theoretically known about since the legislation was first proposed in September 2015, there remain a number of areas of the securitisation markets for which the practical implications have yet to be properly worked through.

The due diligence obligation on investors has also expanded in scope. EU pension funds (and those who manage their assets) and UCITS (whether self-directed or UCITS management companies) are now subject to EU securitisation rules for the first time. Also, non-EU AIFMs who market funds into the EU also appear to be in scope even where they are only marketing into the EU on a private placement basis⁵ (using so-called "**Article 42 registrations**"), which was not the case under the previous rules.

As to content, the securitisation obligations being recast can be broken down into three main categories: risk retention, transparency and due diligence. We break down the differences between the existing EU rules and the new ones for each of these categories in table format below.

Risk retention

The level 1 changes

	Old Securitisation Framework ⁶	Securitisation Regulation
Nature of retention obligation	Indirect. ⁷ EU regulated investors must check compliance. No direct obligation on retainer to retain, and retention can be avoided where there is no need to make the deal eligible for EU regulated investors.	Direct and indirect. One of originator, sponsor and original lender has a direct obligation to retain. They must agree who will hold retention, with originator being the "fallback" retainer in the absence of agreement. EU regulated investors must also check compliance.
Retention rate	5%	Unchanged
Retention methods	5 accepted methods, including vertical slice, originator share, random selection, first loss (portfolio), or first loss (asset-by-asset)	Unchanged

³ EU sponsors will be regulated by their very nature. It seems, however, that third country (i.e. non-EU) sponsors may be permitted going forward, which would make their regulatory status dependent upon the local regulatory regime (if any) wherever they are established. Clarification is being sought from authorities on this point.

⁴ In general this will only apply where the relevant entity is established in the EU, but see below for a discussion of the geographic scope of the Regulation.

⁵ This expansion in scope does not appear to have been fully thought through.

⁶ For these purposes, we are referring to the risk retention obligations previously provided for under the CRR, AIFMD/AIFMR and Solvency II.

⁷ Note, however, that market participants would typically have required contractual obligations on relevant "sell" side parties in transactions marketed to EU regulated investors.

Eligible retainers	Originator, sponsor, original lender	Unchanged, except that "sole purpose" originators who exclusively exist to securitise assets are now banned from retaining risk.
Adverse selection test	None, save the general CRR obligations not to engage in adverse selection.	Securitized assets should not be chosen such that they perform significantly worse than "comparable assets held on the balance sheet of the originator" over the life of the transaction (to a maximum of 4 years). Sanctions apply if they are and this is the intention of the originator.
Retention on a consolidated basis	Only for EU-regulated financial groups.	Unchanged.

Unfinished business

Risk retention is an area where regulatory technical standards ("RTS") are mandated, and the European Banking Authority did indeed produce final draft standards in a report dated 31 July 2018.⁸ The Commission has still not provided any formal response to these draft standards, leading to market concern that certain aspects of them had been objected to, even though no formal rejection or request by the Commission for changes has been made.

The consequences of this are twofold:

- The transitional provisions of the Securitisation Regulation specify that the existing RTS made under CRR should be followed until such time as the new RTS apply. The trouble with this is that risk retention structures are meant to be put in place once, for the life of the transaction, and it is not clear that transactions put in place during the interim period from 1 January until the new RTS applies will be grandfathered. Therefore, to the extent the new rules are more restrictive, it's possible transactions would need to be unwound following the adoption of the new standards.
- This, in turn, leads to broader uncertainty because a number of important market participants will have a low tolerance for the risk that their transaction may not be risk retention compliant once the new rules are made. There are also entirely novel issues (such as the specifics of the adverse selection test and the definition of a "sole purpose originator") that were not addressed in the existing RTS made under the CRR.

Practical approach

In practical terms, there are also two helpful factors to bear in mind:

- There is precedent for the current situation. The CRR (which changed the retention rules) began to apply on 1 January 2014, but the RTS made to specify the detailed rules were not applicable for several months after that. As a result, for the first several months of 2014, transactions proceeded on the basis of the level 1 text alone, which was sufficiently clear for plain vanilla transactions (e.g. standalone public securitisations of prime residential mortgages with a single originator). Now, as then, more complex arrangements may have to wait for the RTS to be finalised, but these kinds of plain vanilla arrangements will normally have sufficient information to comply based on the level 1 text alone.
- The final draft RTS published by the EBA in July preserves in very large part the substance of the RTS made under the CRR. Accordingly, it seems quite likely that the rules around e.g. how to retain when there are multiple originators, will stay the same. This is an improvement on the situation in the early part of 2014 when it was clear that quite a lot of the rules were likely to change but there was very little clarity about what form that change would take. In addition, where there are "new" rules such as the ban on sole purpose originators retaining, these are mainly just codifications of existing informal guidance and market practice, so the functional outcomes are not likely to change significantly from current practices.

⁸ <https://eba.europa.eu/documents/10180/2298183/Draft+RTS+on+risk+retention+%28EBA-RTS-2018-01%29.pdf>

Accordingly, although risk retention is complex and important to get right, it seems as though the market will be able to have reasonable confidence for most relatively straightforward transactions even before the risk retention RTS are finalised. More complex and innovative structures, on the other hand, may be held back from issuing until the rules are fully clarified.

Transparency

The level 1 changes

	Old Securitisation Framework ⁹	Securitisation Regulation
Source of disclosure obligations	Prospectus Directive, Transparency Directive, stock exchange rules, CRR, Solvency II, AIFMR, central bank liquidity scheme rules, as appropriate to the particular transaction.	Securitisation Regulation. Prospectus Directive (or Prospectus Regulation, from 21 July 2019), Transparency Directive, stock exchange rules, central bank liquidity scheme rules continue to apply as appropriate.
Nature of disclosure obligations	A combination of direct (on the sell side) and indirect (on regulated investors to diligence certain specific information). Information investors are required to diligence does not necessarily marry up with information sell side is required to disclose. Which disclosure/diligence obligations apply depends heavily on regulated status of originator, sponsor, original lender and investors. Depends also whether there is a public offer, whether and where the transaction is listed, and whether central bank liquidity scheme eligibility is desired. Potential to avoid most detailed/public disclosure obligations, where so desired.	Direct and indirect. Direct disclosure obligations apply regardless of regulated status of originator, sponsor or issuer/SSPE. EU regulated investors required to diligence information that broadly mirrors what originator, sponsor and SSPE are required to disclose. Detailed disclosure required in all cases, regardless of whether the transaction is public or private transactions. Securitisation Regulation disclosure obligations sufficiently detailed and onerous as to make others (bar the prospectus obligations) largely negligible.
Audience for disclosure	Depends heavily on factors listed above. Potential to avoid most detailed/public disclosure obligations, where so desired.	In theory, only to investors, competent authorities and, upon request, to potential investors. In practice, private transactions may be able to stick to this, but public transactions will end up disclosing to the public at large. See next row.
Mechanism for disclosure	Depends heavily on factors listed above. Potential to restrict disclosure of information to private/specifically negotiated means where so desired.	Public transactions (i.e. where a prospectus is required to be published under the Prospectus Directive) must disclose to a regulated securitisation repository or (where none exists) on a website meeting certain prescribed standards. Private transactions do not have a prescribed mechanism for disclosure provided investors, competent authorities and, upon request, potential investors can access information.

⁹ For these purposes, we are excluding obligations under Article 8b of the Credit Rating Agencies' Regulation and the associated regulatory technical standards. Although these obligations were formally in force and applied between 1 January 2017 and 31 December 2018, they have never been capable of being complied with so they are not *de facto* applicable.

		Certain national competent authorities ("NCAs") may prescribe the method, frequency and content of information to be reported to them on private transactions. ¹⁰ Parties will need to check the approaches of the relevant NCA(s).
Content that must be disclosed	Depends heavily on factors listed above. Potential to restrict disclosure of information to specifically negotiated items where so desired.	Full transaction documentation, including prospectus or (where there is no prospectus) a deal summary, loan level data on a prescribed template, investor reports on a prescribed template, reports of any significant events/material changes on a prescribed template. Additional items such as the STS notification (in prescribed format), a liability cash flow model and (where available) environmental data must be disclosed for STS securitisations.
Frequency of disclosure	Depends heavily on factors listed above. Potential to restrict disclosure of information to specifically negotiated items where so desired.	Full transaction documents, prospectus/deal summary and (where appropriate) STS notification and liability cash flow model before pricing. Loan level data and investor reports quarterly (or monthly for ABCP). Significant events/material changes to be reported without delay.

Unfinished business

Disclosure is perhaps the area worst affected by the lack of finalised technical standards and guidelines. In particular, the requirements to provide loan-level data and investor reporting clearly require further specification to be capable of compliance. Event-driven reporting was not initially thought to require this, but ESMA publishing draft templates for this as well has put that position in some doubt.

ESMA released its final draft RTS around the content of the reporting obligations and annexed draft disclosure templates on 22 August 2018.¹¹ This final report was the subject of a great deal of controversy, not least because it departed very significantly from the approach previously consulted upon and introduced, for the first time, the idea that private transactions would have to report using the detailed disclosure templates – this despite a consultation that explicitly scoped private transactions out of the obligation to report on legislatively prescribed templates.

This change was (and continues to be) viewed as exceptionally problematic in many areas – especially sections of the market that have historically thought of themselves as private, including ABCP transactions, synthetics, cash CLOs and a number of loan-on-loan financings. In each of these cases, market participants (quite reasonably) did not fully engage with the consultation exercise of coming up with disclosure templates because they relied on ESMA's assurances that they would not have to report on those templates. When ESMA made clear in its final report that even private deals would need to report using templates, they did not then reopen the consultation. As a result, some market participants never really had a meaningful opportunity to comment.

Since then, the Commission has sent these RTS back to ESMA for redrafting,¹² which is currently in process. This is not expected to produce large changes in the contents of the disclosure annexes. Rather, it is expected mainly to clarify what is required to be disclosed in some previously ambiguous fields and provide additional flexibility to use "no data"

¹⁰ See, for example, the draft direction from the UK's Prudential Regulation Authority and Financial Conduct Authority in this respect: <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/securitisation-regulation-pra-and-fca-joint-statement-on-reporting-of-private-securitisations>

¹¹ https://www.esma.europa.eu/sites/default/files/library/esma33-128-474_final_report_securitisation_disclosure_technical_standards.pdf

¹² https://www.esma.europa.eu/sites/default/files/library/6771757_-_maijoor.pdf

responses to fill in templates where it is impractical to obtain the information. Even these minor changes are mainly expected to affect ABCP templates, which would leave significant difficulties to be faced by other sections of the private securitisation market.

In addition, the European Supervisory Authorities (that is, EBA and ESMA, together with the European Insurance and Occupational Pensions Authority, collectively the "ESAs") published a joint statement¹³ on 30 November 2018 aiming to smooth the transitional problems by encouraging NCAs to take a proportionate and risk-based approach to enforcement of the disclosure obligations until the Securitisation Regulation rules in this respect were finalised. While this is helpful, it leaves a number of issues outstanding – not least because neither the ESAs (individually or collectively) nor the NCAs have power to formally suspend application of legislation or issue US-style "no action" letters, even in situations where it is self-evidently impossible or impractical to comply.

Moreover – and quite apart from the ongoing difficulties with the technical standards needed – a number of elements of the level 1 text remain uncertain. A significant aspect of this is the confusing application of the disclosure requirements with respect to ABCP (as to which see below). More generally, it is not clear how far the flexibility in respect of disclosure obligations to accommodate confidentiality concerns extends. In theory, parties may adjust disclosure of information on the basis it is subject to an obligation of confidentiality. The rules around confidentiality make it possible for parties to comply by anonymising or aggregating data in some cases and summarising documents in others, but there is a difficult tension left unresolved in the Regulation's text between the requirement to provide information under the Regulation on the one hand and the need to protect legitimate commercial and other confidentiality on the other. It would obviously be an abuse, for example, to include a confidentiality clause in all deal documents and, on that basis, refuse to make them available. On the other hand, some contractual confidentiality obligations are evidently meant to be effective to protect from disclosure under the Regulation's transparency rules or there would not be a reference in those rules to complying while nonetheless respecting "any confidentiality obligation relating to customer, original lender or debtor information".

As to ABCP, the approach to disclosure compliance in general is extremely confusing. Although certain efforts were made to adapt the regime for ABCP, many aspects of it are still awkward and difficult to interpret and apply to the product. It is not clear, for example, what constitutes "underlying documentation that is essential for the understanding of the transaction". The best view is that this must mean programme-level documentation rather than documentation relating to individual ABCP transactions – the confidentiality of which is clearly intended to be protected by e.g. the aggregate reporting provisions elsewhere. But then the liquidity facility is required specifically to be disclosed, and that is often a transaction-level document rather than a programme-level document.

A similar issue will arise on non-granular securitisations (common among CMBS transactions) where it remains to be seen whether the individual loan documents will be viewed as "essential to the understanding of the transaction" and disclosed (presumably in redacted form) or the current practice of providing detailed summaries will continue.

Finally, the technical standards around the authorisation of securitisation repositories, how and when to make submissions to repositories, what information can be requested from them, by whom and within what deadlines are all required in order for the securitisation repository mechanism to be practically workable. ESMA has also published a final report with technical standards covering these areas,¹⁴ but – like the final draft risk retention RTS – this is currently sitting in the Commission's inbox with no formal response to date.

Practical approach

The result of all of the above is that market participants will - in general - need to take a pragmatic view in order for there to be issuance. In practical terms, the below are likely to be applicable:

- Many aspects of Article 7 (containing the disclosure requirements) of the Securitisation Regulation do not require further clarification by technical standards. These will need to be complied with on all in-scope securitisations immediately. That is to say it will be necessary to disclose transaction documents, a transaction summary (where there is no prospectus), the STS notification (where relevant) and undertake event-driven reporting. The lack of templates will not provide an excuse to delay compliance with these obligations.
- Market participants executing public deals will need to keep an eye on the ESMA website to see whether any securitisation repositories have been authorised. To the extent there are none, they will need to report to an

¹³ https://esas-joint-committee.europa.eu/Publications/Statements/JC_Statement_Securitisation_CRA3_templates_plus_CRR2_final.pdf

¹⁴ https://www.esma.europa.eu/sites/default/files/library/esma33-128-488_final_report_repositories_technical_standards.pdf

appropriate website. It may be sensible to work with one of the organisations known to be applying for authorisation as a securitisation repository in order to facilitate the transition from that website to an authorised repository more smoothly once authorisation is obtained.

- Market participants doing private deals will need to keep in touch with their NCAs to make sure they understand and can comply with any local reporting requirements for private deals that may apply.
- Where there is a CRA3 template relevant for the transaction¹⁵, practical efforts should be made to report according to those templates, particularly on public deals. To the extent there are gaps, it will be helpful if parties can point to a historical market practice that is being followed. If much of the information required for the CRA3 template is currently being provided in other formats (particularly on private deals) then it is likely such information can continue to be supplied in the same manner.
- Where there is no CRA3 template relevant for the transaction, it may be useful to consider the ESMA templates that were issued in draft on 22 August 2018 and make an effort to comply with those to the extent practicable. Strict compliance with these draft templates is, of course, not necessary but this will likely ease the process of eventual transition since the current expectation is that those templates will not change significantly. Again – to the extent historical market practice can be pointed to, that will be helpful in demonstrating interim compliance with Article 7.
- On confidentiality, transaction parties will need to take a sensible, good faith approach. History will be a good guide as to what information can legitimately be protected as "confidential" (e.g. originator names on ABCP transactions), but equally it will be important to comply with the spirit of the Regulation, which is clearly to have investors rely less on offering documents and summary data provided by originators, sponsors and issuers in favour of making more granular and primary sources available to them. On non-granular securitisations, the solution may be to provide a "summary" of the document that is simply a redacted version that does not include confidential information such as account numbers, signatures and margins. Where it is not possible to anonymise or summarise confidential information (as will often be the case for CLOs), the solution may be to remove a loan from the deal.
- Regardless of the specific circumstances of a transaction, it will be helpful for institutions to have an internal policy about how they approach compliance to be able to demonstrate that they have considered the issues and adopted a consistent, reasoned approach. This will be helpful in demonstrating good faith and due diligence should regulators seek to challenge whatever approach is eventually taken. This is especially true for ABCP and confidentiality issues where the level 1 text is difficult to interpret and apply, and no guidance is expected.
- Originators and sponsors on private deals will also need to consider their approach to the concept of a "potential investor". Any potential investor is entitled to the information set out in Article 7, but no definition is provided of this term. In general, this has historically been (and we expect it will continue to be) an area where market participants take a case-by-case approach as to who is a *bona fide* potential investor. On a public deal, that might be anyone qualified to invest, but on a private deal with transfer restrictions, that universe may be limited to people the originator is happy have invest in the transaction, for example.
- On the investor side, it will be necessary to diligence compliance with the disclosure obligations. A similarly pragmatic approach will need to be taken by investors, bearing in mind the ESAs' statement of 30 November, in order to satisfy this obligation.
- The final element where a pragmatic approach will be needed will be around the distinction between private and public transactions. While that line is formally drawn around the need to publish a prospectus under the Prospectus Directive (soon to be Prospectus Regulation), the market is likely to undertake reporting to a securitisation repository on a voluntary basis more widely even where this is not strictly required by the definition of a public transaction. More particularly, this may well be the approach for underwritten, widely offered transactions that would historically be thought of as "public" deals but are listed on a market which is not a regulated market (e.g. the Global Exchange Market of the Irish Stock Exchange or the Euro MTF of the Luxembourg Stock Exchange). There is a concern that if these deals fail to report to a securitisation repository it may create a sense in the official community that the market is seeking to avoid providing the data transparency sought by policymakers on a technicality – with the result that the

¹⁵ CRA3 templates exist for residential mortgages, commercial mortgages, loans to SMEs, auto loans, consumer loans, credit card loans, and leases to individuals and/or businesses.

legally-mandated review of the situation¹⁶ could well lead to further onerous reporting obligations being imposed on what are in substance private transactions in the future.

Due diligence

	Old Securitisation Framework¹⁷	Securitisation Regulation
What type of institutional investors are in scope	Credit institutions, investment firms, alternative investment fund managers, insurers and reinsurers.	As with current framework, plus pension funds, internally managed UCITS and UCITS management companies. Non-EU AIFMs marketing in the EU on the basis of national private placement regimes may now also be covered. ¹⁸
Specific items to be diligenced	Vary somewhat from regime to regime. Not well-matched to information otherwise required to be disclosed by the sell side. The AIFM regime requires diligence of the credits granted by the originator/sponsor generally, not just the assets securitised.	Harmonised for all types of institutional investor. Generally limits diligence to the underlying assets of the securitisation and the behaviour of the entities involved in respect of the underlying assets. New requirement to establish written procedures to monitor ongoing compliance.
Requires verification of compliance with direct disclosure obligations?	No. Requires only that the investor be able to check the specific items it must verify under the legislation.	Yes. Investors required to check that all information required to be disclosed has been disclosed, even where not otherwise relevant for diligence procedures. Investors required to diligence the STS notification (where relevant) even where STS status is not relevant to their investment decision.
Right to delegate diligence obligations	Never officially provided for or formally sanctioned. Was nonetheless common practice, but with uncertain legal consequences if diligence was not carried out to the legally required standard.	Formal authorisation for institutional investors to delegate the obligation to carry out regulatory diligence to a third party. Applies only where that third party is itself an institutional investor and makes investment decisions on behalf of the principal.
Secondary legislation to clarify diligence obligations	Yes. Under CRR these were combined with the risk retention RTS and were a useful way of clarifying, in particular, that a proportionate approach could be taken to compliance, which facilitated e.g. the operations of bank trading desks.	No secondary legislation provided for. Institutional investors will need to speak to their regulators and consider their own approaches. This has presented a number of challenges for institutional investors, especially with respect to proportionality issues.

Unfinished business

As mentioned above, no secondary legislation is mandated in respect of the due diligence obligations, so in that sense the regime is "complete". This, however, does not give the whole picture. It is clear that there are a number of areas

¹⁶ Article 46 of the Regulation mandates a review of the use of the private transaction exemption from reporting to securitisation repositories. Article 46(d) specifically requires the Commission to express a view about whether full, public-style reporting obligations should be extended to private transactions.

¹⁷ For these purposes, we are considering only securitisation-specific diligence obligations.

¹⁸ This concern arises from the definition of "institutional investor" in the Regulation that includes any AIFM that "manages and/or markets alternative investment funds in the Union". Clarification has been sought from ESMA as to whether this intended to cover any marketing or only marketing based on an AIFMD passport. Until that clarification is issued, many large AIFMs are taking the cautious approach that any marketing, including marketing in reliance on so-called Article 42 registrations, would be sufficient to bring them into scope.

where additional guidance from regulators would be helpful, some of which are reasonably fundamental to the operation of the regime. These include:

- Proportionality. The ability of investors to take a proportionate approach to diligence is alluded to in the recitals to the Regulation but is not explicitly authorised in the way it was under the previous regime. Given that doing full diligence on every trade (and, in particular, trades where investment banks act as "riskless principals") would cause the secondary trading markets to grind to a halt, a complete removal of the flexibility to comply on a proportionate basis cannot have been intended by the policymakers.
- The circumstances in which diligence is required. Historically, regulatory diligence obligations have not been triggered in respect of swap providers or liquidity providers on most transactions.¹⁹ Because of changes to the structure of the level 1 text from CRR to the Regulation, and restrictions on the ability of the EBA to give guidance, this is now less certain. From a policy point of view, there does not seem to have been any change and the issue was not raised by policymakers, but there is nonetheless more room for doubt now about whether swap providers and liquidity providers are intended to be subject to the obligation to do regulatory due diligence over and above their internal, commercially-driven diligence practices.
- The approach to third country securitisations. The obligation to check compliance with EU disclosure obligations²⁰ is oddly worded, leading some to argue that EU institutional investors need not check that Article 7 disclosure obligations are complied with by third country originators, sponsors or issuers. This approach seems fundamentally at odds with the policy objectives of the diligence obligations, but clarification has been sought from the authorities.

Practical approach

In practice, investors will need to take an informed, pragmatic view in consultation with their internal compliance/legal functions and, where appropriate, external advisors and NCAs. As with issuers and disclosure obligations, it will be very helpful for institutional investors to have a written policy that describes their approach to compliance and then follow it consistently. This will demonstrate good faith and due diligence in attempting to comply with the new regime.

OTHER LEVEL 1 ISSUES

In addition to recasting the risk retention, transparency and due diligence obligations, there are a number of other items in the Securitisation Regulation legislative package that are worthy of note, some of which also have some unfinished business.

Application on a consolidated basis

The amendments to the CRR that accompanied the Regulation have the (unintended) effect of forcing EU-established credit institutions and investment firms to apply large parts of the Securitisation Regulation on a consolidated basis, throughout the globe. These include the risk retention, transparency and due diligence obligations discussed above as well as the ban on resecuritisation and the rules on credit granting discussed below. This represents a very significant expansion of a previously manageable rule that mainly affected diligence obligations.

Although there has been political agreement in the context of the CRR "risk reduction package" to amend this rule in a way that would largely reinstate the *status quo ante*, the unintended, problematic version of it is currently applicable. Until the amendments are finally adopted and become applicable (which is potentially several months away), this rule puts EU banks with securitisation operations (including trading activity) in third countries in a very difficult position.

In practical terms, we expect most institutions will choose to engage with their principal prudential regulators and seek comfort that they can rely on the fact that the current version of the rule was never intended (as evidenced by the political agreement to change it) and carry on largely with business as usual.

¹⁹ Provided they were not taking "credit risk" on the transaction – that is, risk of principal losses. This was deemed to be the case where the swap or liquidity facility had certain common features.

²⁰ Under Article 5(1)(e) of the Regulation.

Jurisdictional scope

Unfortunately, the jurisdictional scope of the Regulation is nowhere formally limited or defined. Over the year or so that the Regulation has been in the Official Journal, however, the market has developed what appears to be a consensus approach to this issue. That is, jurisdictional scope should be thought about in terms of transaction parties rather than transactions. The Regulation will need to be considered where any party to it (notably, originator, sponsor, original lender, issuer or investors) is in-scope. In turn, the Regulation's reach is limited to parties who are subject to supervision by an NCA designated under Article 29 of the Regulation.

Because this is a market consensus approach, rather than an approach set out in the text, a certain amount of compliance uncertainty remains. This is a matter that has been repeatedly raised with regulators by industry representatives and it is hoped that it will be resolved by guidance issued by regulators in one form or another.

Problems for acquired portfolios

The Regulation carries over and expands the scope of rules on credit granting from the CRR. In particular, it requires that originators, original lenders and sponsors apply the same sound and well-defined criteria for credit granting to securitised and non-securitised exposures. This is relatively uncontroversial on its own, except that it requires that originators who are securitising an acquired portfolio check that the original lender complied with this requirement at the time the asset was created. Especially for older portfolios, this will often be difficult if not impossible for entirely legitimate reasons; the original lender may no longer exist or the records required to verify this may have been lost or destroyed – particularly if a securitisation was not contemplated at the time the assets were created or indeed when the portfolio was originally sold.

Fortunately, the regulators have recognised the difficulties caused by this language and it is hoped guidance will be provided shortly that will clarify this obligation as it relates to acquired portfolios. In substance, market participants hope that the guidance will confirm that acquired portfolios may be securitised even where the original credit granting criteria are not available, provided the originator acquiring and securitising the portfolio has made appropriate efforts to diligence the credit granting standards used in connection with the portfolio and has faithfully reported the results of those efforts (including any lacunae in information) to investors.

Ban on resecuritisation

The Regulation formally bans resecuritisations, which were anyway rarely seen in Europe following the financial crisis. However, the ban is problematic for a number of reasons, not least of which is that it is a ban in the abstract that doesn't purport to impose any obligations on any particular party. It says only that the "underlying exposures used in a securitisation shall not include securitisation positions", but not, e.g. that investors may not buy resecuritisations, or that originators/sponsors may not structure them. It is therefore unclear how the ban operates and what the consequences are (and on whom) for a breach. There does, however, appear to be an emerging market consensus on the conservative end of the scale – that no in-scope entity should play any role on a banned resecuritisation.

It is also problematic because various specific instances of resecuritisations are permitted, and fully supported ABCP programmes are not considered resecuritisations "for the purposes of this [ban]", which suggests that they might be resecuritisations for other purposes – a problematic outcome if that view is taken by regulators (again not least because this has not been the general view taken by market participants previously). It remains to be seen how this will play out in practice, but this is a possible source of market friction that will need to be monitored going forward.

STS

STS is, somewhat counterintuitively, one of the areas that is most advanced. While there will undoubtedly be difficulties with compliance, these stem largely from the basic requirements of the Regulation (compliance with the Article 7 transparency obligations, for example, is required for STS status – so uncertainty there also affects STS). The EBA has largely finalised its guidelines on interpretation of the STS criteria, helping to promote a common understanding of these criteria. Those guidelines are, by and large, extremely sensible and helpful.

Likewise, the ESMA work on STS notification is largely complete and appears to be the only area where secondary legislation is not being held up by the Commission well into 2019.

The one area affecting STS that is seriously lagging is the RTS on the meaning of homogeneity. A very sensible final draft RTS was produced by the EBA on 31 July 2018 but, as with a number of other secondary measures, this remains in the Commission inbox. We understand that this may be because there are some objections from within the Commission, but the nature of these objections and what changes might be needed to address them are so far unclear.

The practical consequence of this is that it may still be possible to do STS transactions but, as with risk retention, only the transactions with straightforwardly homogenous portfolios are likely to attempt it before the RTS is finalised.

IMPACT ON DOCUMENTATION

The markets are already considering what changes will be necessary to documentation to reflect the new regulatory framework. Updating legislative references is a necessary but relatively straightforward aspect of this. Slightly less straightforward will be new risk factors and descriptions of the regulatory framework that need to go into disclosure documents. On the more difficult end of things will be the approach to disclosure in respect of STS and any realignments necessary in transaction documentation to allocate the risk of liability that arises from the new regulatory framework. There are reasonably obvious starting points in both of these cases, but any market standard position will necessarily have to result from negotiation on individual deals. Nonetheless, it would be useful for market participants to start thinking about their ideal approaches to these issues so that they are prepared when they come up on their next transaction.

CONCLUSION

The application on 1 January 2019 of the Securitisation Regulation was always going to cause some disruption – any major change to a regulatory framework always will. Unfortunately, the disruption actually caused is much greater than was necessary or intended because the framework began to apply well before it was complete. Making matters worse, it was always set up to apply in a "big bang" way, as opposed to taking a staged approach so that, e.g. securitisation repositories and third party verifiers of STS status could be authorised and ready to go by the time the rest of the market had need of their services.

There remains a lot of work for regulators and policymakers to do, resulting in much unfortunate uncertainty for market participants who wish to issue before that work is done. This is especially surprising in the context of a Regulation the intention of which was to promote the revitalisation of the European securitisation markets. For the moment, at least, it runs the risk of having precisely the opposite effect.

Nonetheless, for the more straightforward public transactions, the market should find a way to continue operating in the interim. For all others, we hold out hope that the outstanding issues will be resolved rapidly so that certainty and predictability allow the return of the healthy, vibrant and safe securitisation markets intended to be promoted by the Regulation in the first place.

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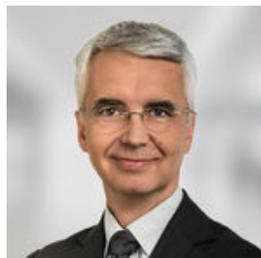
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