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Securitisation Regulation Update

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Print Forward Contact

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European Commission publishes major changes to European securitisation rules

Summary

As part of its implementation of the Action Plan on 30 September, the EC issued two draft regulations on securitisations. If implemented, these regulations will make some major changes to European securitisation rules including the creation of a simple, transparent and standardised (**STS**) designation for securitisation. Investments in STS securitisations will benefit from preferential regulatory capital treatment. However, originators, sponsors and SSPEs of STS securitisations will be jointly responsible for determining that a securitisation complies with the STS criteria.

Note also that the draft regulations consolidate and make changes to the rules applicable to all types of securitisation in Europe (not just to STS securitisations).

The draft regulations, if implemented largely as proposed, will likely have an impact on securitisation markets far beyond the borders of Europe, as issuers and investors in the U.S., Canada, Australia and elsewhere grapple with the consequences of a two-track securitisation regime very different from what is and likely will be in place in their home countries.

Background

On 30 September 2015, the European Commission (**EC**) published its much anticipated Action Plan (**Action Plan**) on Building a Capital Markets Union (**CMU**). The publication of the Action Plan follows the launch of a Green Paper: Building a Capital Markets Union, together with a consultation paper on the creation of a high-quality securitisation market and a further paper proposing a review of the Prospectus Directive on 18 February 2015. Responses were requested by 13 May 2015, following which a conference took place over the summer prior to the publication of the agreed Action

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Plan. For more information on the broader measures outlined by the EC in the Action Plan, please refer to our publication "Action Stations as EU Publishes CMU Action Plan".

As part of its implementation of the Action Plan on 30 September, the EC issued two draft regulations on securitisations. If implemented, these regulations will make some major changes to European securitisation rules. The proposed regulations can be accessed by clicking here.

The first regulation will harmonize rules on risk retention, due diligence and disclosure across the different categories of European institutional investors which will apply to all securitisations (subject to grandfathering provisions) and will introduce a new framework for simple, transparent and standardised securitisations (the **Securitisation Regulation**). The Securitisation Regulation will also repeal existing provisions what would otherwise become overlapping in legislation relating to the banking, asset management and insurance sectors.

The second regulation will implement the revised Basel framework for securitisation in the EU and implement a more risk sensitive prudential treatment for STS securitisations similar to that recommended by the EBA (the **Amending Regulation**).

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The key points

- **STS and "non-STS" securitisations**: The Securitisation Regulation draws a distinction between STS securitisations (which meet the STS criteria) and those securitisations which do not meet the criteria (non-STS securitisations). The main benefit of a securitisation complying with the STS criteria will be preferential regulatory capital treatment for institutional investors. However, originators, sponsors and SSPEs of STS securitisations will be jointly responsible for determining that a securitisation complies with the STS criteria and will be liable for any loss or damage resulting from incorrect or misleading STS notifications.

- **Rules applicable to all securitisations**

    - **Definition of "Originator":** The Securitisation Regulation amends the definition of "originator" for the purposes of the risk retention provisions by providing that "*an entity shall not be considered to be an originator where the entity has been established or operates for the sole purpose of securitising exposures*". Although it appears that the EC has softened this provision during the course of drafting this legislative proposal, this definition of "originator" may well still be of concern to those market participants involved in issuance of securitisations involving portfolio sales and platform lending as well as CLOs, particularly given the statement in the explanatory memorandum to the Securitisation Regulation that "*the entity retaining the economic interest has to have the capacity to meet a payment obligation from resources not related to the exposures being securitised".*

- **Harmonisation:** The Securitisation Regulation repeals the disclosure, due diligence and risk retention provisions in the CRR, AIFM and Solvency II legislation and replaces them with one set of shorter, harmonised rules to apply across all financial sectors to banks, investment firms, insurers, alternative investment managers, UCITS and Institutions for Occupational Retirement Provision (**IORPs**), where relevant.

- **New regulatory technical standards:** While it appears that regulatory technical standards will be prepared in due course in relation to risk retention and disclosure standards, the Securitisation Regulation does not confirm that such standards will also be prepared in relation to the new due diligence requirements. In relation to disclosure standards, it appears that, as currently drafted, the disclosure requirements would apply to all securitisations, including private and bilateral securitisations; it is hoped that this position will be clarified in due course, given ESMA's workstream on disclosure obligations on private and bilateral transactions.

- **Rules applicable to STS securitisations**

  - **STS Criteria:** There are separate but broadly similar STS criteria for term securitisations and asset backed commercial paper (**ABCP**), which take account of their structural differences; this differs from those criteria published by the Basel Committee on Banking Supervision (**BCBS**) and IOSCO, which did not take account of ABCP at this time. Currently, only "true sale" securitisations can be STS securitisations. The liquidity coverage ratio (**LCR**) requirements and the treatment of securitisations under Solvency II will also need to be updated to reflect the final STS criteria once the Securitisation Regulation is finalised.

  - **STS and ABCP:** The criteria for ABCP, as currently drafted, contain some issues of significant concern to the ABCP industry. There are extensive disclosure obligations, including those in relation to the disclosure of information on the underlying exposures, which would threaten the ability of ABCP transactions to maintain anonymity in relation to underlying assets. All transactions within an ABCP programme would have to meet the STS requirements in order for ABCP securitisations to be considered compliant.

  - **STS and synthetic securitisations:** The EBA is currently preparing draft criteria for synthetic securitisations for review by the EC. Re-securitisations cannot be STS securitisations.

    - The originator, sponsor or SSPE shall provide access to static and dynamic historical default and loss performance data for "substantially similar" exposures to those securitised in respect of a period of no less than five years for retail exposures and no less than seven years for non-retail exposures. Disclosure must also be made of the basis for claiming similarity.

    - A file audit by an independent party to a 95% confidence level. Although common for some asset classes file audits are not universally undertaken at present.

    - The originator or sponsor shall provide a liability cash flow model to investors and maintain this on an on-going basis. This was removed, following consultation with the industry, from the CRA 3 regulatory technical standards on disclosure requirements for structured finance instruments.

  - **Determination of STS status**: To the extent that STS status is claimed, the originators, sponsors and SSPEs will be jointly responsible for determining that a securitisation complies with the STS criteria and for notifying EMSA accordingly using a template created by the European Supervisory Authorities (**ESAs**). The ESAs will have 12 months following the entry into force of the Regulation to provide further detail of the information to be provided in the STS notification and to determine the form of the template.

  - **Liability for STS status**: Of greater concern is that originators and sponsors will be liable for any loss or damage resulting from incorrect or misleading STS notifications, particularly given the severity of the sanctions. ESMA will be required to maintain a list of STS securitisations and a list of securitisations which have been determined to no longer be compliant with the STS criteria and will be under an obligation to inform ESMA as soon as a securitisation

becomes non-compliant with the STS criteria. Securitisations issued before the Securitisation Regulation comes into force will only be permitted to be designated as STS securitisations if they comply with the STS criteria.

- **Application and Grandfathering Arrangements**: The position on grandfathering of existing securitisations is not entirely clear in the draft Securitisation Regulation, in particular in relation to those securitisations entered into on or after 1 January 2011 (or to which new exposures were added or substituted after 31 December 2014) but before entry into force of the Securitisation Regulation. Based upon the current proposals and assuming that the lack of clarity were resolved, it appears that the Securitisation Regulation would apply as summarised below.

Date of Issuance of Securitisation or Addition or Substitution of New Exposures	**Relevant Legislative Provisions**
Before 1 January 2011 (assuming no new exposures have been added or substituted to the transaction after 31 December 2014)	The Securitisation Regulation will not apply. Existing requirements under the CRR, Solvency II, AIFMD and CRA 3 will apply.
On or after 1 January 2011 (or to which new exposures were added or substituted after 31 December 2014) but before entry into force of the Securitisation Regulation	Institutional investors may only be subject to the new due diligence rules in the Securitisation Regulation and the risk retention rules currently applying under the CRR, Solvency II and AIFMD regimes. This could prove problematic where the existing risk retention requirements do not meet the standards required under the new harmonised provisions.
On or after the date of entry into force of the Securitisation Regulation (or to which new exposures were added or substituted on or after the date of entry into force of the Securitisation Regulation.	The Securitisation Regulation will apply.

- **Derivatives Transactions**: The Securitisation Regulation has been amended to try to align the treatment of OTC derivatives entered into by SSPEs with those entered into by covered bond entities. The exemption from the clearing requirement would apply to STS securitisations only and the nature of any exemption granted from margining requirements would also appear to only apply to STS securitisations.

- **Capital Requirements**: The Amending Regulation will implement a new hierarchy of the three approaches for calculation of capital requirements, under the CRR, following the recommendations set out in the revised Basel framework for securitisations, which was published by the BCBS in December 2014. The Amending Regulation will also adopt a more risk-sensitive prudential treatment for STS securitisations, broadly similar to that proposed by the EBA in its report on qualifying securitisations. The three approaches are re-calibrated in order to generate lower capital charges for positions in transactions qualifying as STS securitisations. In addition, senior positions in STS securitisations will also have the advantage of being subject to a lower floor of 10% (a floor of 15% which will continue to apply to non-senior positions in STS securitisations and to non-STS securitisations).

- **Next Steps and Timing**: The proposed regulations have been sent to the European Parliament and the Council for review and adoption under the co-decision procedure. This process could be lengthy and could well take at least a year. Once adopted, the Securitisation Regulation and the Amending Regulation will be directly applicable in member states from the day of entry into force. Once the regulations are in force, the ESAs will be required to prepare the related regulatory technical standards.

About Hogan Lovells
Hogan Lovells is an international legal practice that includes Hogan Lovells International LLP, Hogan Lovells US LLP and their affiliated businesses.

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