

The new EU securitisation regulation: Challenges for ABCP

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Relevance and status of implementation process:

As soon as the new EU securitisation regulation has to be applied as of 1 January 2019, numerous regulations will also be binding for existing securitisations. This is the case when securitisations issue securities on or after 1 January 2019. In ABCP programmes commercial papers are issued constantly. Therefore, ABCP programmes are captured immediately under the new rules. In addition, there are some special rules for STS criteria as far as they relate to existing transactions. However, this means that the provisions of the new EU securitisation regulation must be applied immediately with respect to ABCP securitisations, provided that a timely implementation of the level II regulations succeeds.

Such level II documents are intended to supplement and concretise the provisions of the EU securitisation regulation. This is only the case where the level-I-text contains a corresponding reference to RTS ("Regulatory Technical Standards") or ITS ("Implementing Technical Standards") or Guidelines. Other articles and areas of the EU securitisation regulation must be assessed and evaluated by national supervisory authorities. This could create some uncertainty.

Finally, the deadlines for the submission of RTS/ITS or guidelines were set very late by the legislator, namely on 18.07./18.10. or even on 18.01.2019. It is positive to note that EBA and ESMA are making great efforts to deliver earlier. By now most drafts are in a final or at least revised state taking into account many concerns of the industry – but by far not all. In an ECON hearing on 29 August 2018, the European parliament expressed its strong will to swiftly adopt and implement the level II documents with no material criticism or willingness to block them.

Consequences for originators of ABCP transactions:

The originators of ABCP transactions - mostly unregulated companies, captives or other financing companies - are in any case affected by the new EU securitisation regulation.

Not only must a decision be made as to whether or not the STS status should be applied, but also numerous adjustments must also be made. And this, if possible, by 1 January 2019 or shortly thereafter.

The problem at the present time is that there remains only very little time to implement the requirements on transparency and disclosure that have been published by ESMA's Final Report from 22 August 2019.

According to this final report the information to be provided by the originators would be very extensive and in some cases problematic in terms of content. For example, information on the geographical distribution of debtors according to the "NUTS3

classification" should be provided. Even though there is the possibility to opt for a „no data“ declaration on certain fields, not all requested information has this possibility. It is furthermore unclear what the consequences would be if only a fraction of the required information were to be provided. In any case, the compilation of the (deliverable) information entails considerable IT effort, which either the originator himself or an commissioned IT provider would have to perform. This costs time and money.

In addition to the IT effort required for reporting, adjustments to the underlying documentation are also necessary (especially if the STS criteria are to be met). In this context, the provisions on lending criteria (Art. 5(1) and 9(1) STS-Reg) need special attention. According to these provisions all ABCP transactions require that the originator has solid, well-defined criteria and procedures for his receivables management in place. Furthermore the originator has to have effective systems for applying these criteria and procedures to ensure that lending is based on a thorough assessment of the creditworthiness of the debtor. Whether the current documents sufficiently mirror this has to be examined in each individual case.

The most important question for originators is certainly whether the current pricing of the liquidity line will be maintained in the future. At the next prolongation at the latest, the sponsor bank will have to consider how it can compensate for the increased cost of capital that will apply from 1 January 2020 (for existing transactions). Price increases then cannot be ruled out.

Consequences for sponsors of ABCP programmes:

The biggest impact of the new EU securitisation regulation will certainly affect the ABCP sponsoring banks. Since all ABCP transactions are private securitisations, the data and documentation requirements under Art. 5 to 7 STS-Reg and, in the case of STS transactions, Art. 24 to 27 STS-Reg are not to be provided by a repository but via the sponsor bank. This information goes out to the supervisory authorities and (potential) investors. This requires a significant extension of the current investor reporting with corresponding effects on the sponsor bank's IT infrastructure. Additional documents must also be obtained or prepared (e.g. assurances from the originator and transaction summaries). In the case of STS transactions, additional notifications (pursuant to Art 27 STS-Reg) must be made.

Not to be underestimated is the need to establish new processes for the STS audit at transaction level that enable reliable and consistent compliance with the STS criteria. Because an intentional or negligent violation of the STS criteria can have severe liability consequences for the sponsor. It would probably be necessary to integrate not only front-office and back-office units but also the legal department, risk controlling and regulatory reporting in such processes.

Further adjustments are also necessary, particularly in the regulatory reporting system, due to the changed hierarchy methodology. The reporting software must be adapted and the corresponding delivery systems must be adjusted or extended to the new requirements.

Should a sponsoring bank decide to make its entire ABCP programme STS-compliant, further requirements will be added. These concern IT (e.g. to determine the programme WAL or the concentration limits per CRU at programme level), audits for STS compliance (random sample testing in accordance with Art 26(1) STS-Reg and with regard to servicer expertise), programme documentation and the preparation of the STS notification for the programme level. With regard to the latter, according to the current RTS, ESMA has the perception that a separate notification will be submitted and published for each ISIN - and thus for each individual commercial paper issued. Only then will the reduced capital charge of the commercial papers for the investor be effective.

Under these conditions, it is more than questionable whether an ABCP programme can attain STS status in Europe.

Consequences for investors in ABCP:

For the first time, the new EU securitisation regulation also addresses regulated investors directly. Until now, they have only been affected by their own regulations (e.g. Solvency II, MMFR, CRR or AIFMD). The EU securitisation regulation thus creates a uniform legal framework with regard to definition, due diligence, stress testing, processes and management and supervisory reporting for securitisations. Only non-regulated investors (e.g. large companies or family offices) are excluded.

This means that the individual regulations now also need to refer to the EU securitisation regulation and replace previous, individual securitisation requirements. This has already been implemented for banks (CRR), money market funds (MMFR) and the insurance industry (Solvency II).

The effects vary: While banks and insurance companies are mainly concerned with the capital backing of securitisations - and thus also of ABCP investments, even if they are fully supported -, money market funds are concerned with the question of which securitisations can be acquired at all.

For fully supported non-STS ABCPs (which are most likely prevailing in Europe) this means that banks must continue to provide high and – in terms of insurance companies – prohibitively high capital charges (especially compared to covered bonds). In contrast, European money market funds have the special rule that fully supported ABCP may be acquired - even if they are not STS-compliant. For funds and asset managers according to UCITS and AIFMD, there is as yet no adapted securitisation regulation.

Another, unfortunately not positive development is emerging in the definition of "High Quality Liquid Assets" (HQLA) within the LCR regime. The attempt to declare fully supported ABCP as HQLA has failed. Only STS-eligible securitisations will be able to serve as cover for the LCR regime in the future.

These developments are very regrettable, as they ultimately lead to a decline in demand for ABCP investments and thus to rising prices. This means that the real economy is paying double the price, as not only the cost-of-funds of ABCP refinancing increases, but the higher capital charge of the liquidity lines also creates

additional pressure on margins. In addition, there are the costs of adapting to the increased transparency requirements - whether the transaction is STS or not.

Conclusion:

The impact of EU securitisation regulation on ABCP is complex. Originators and sponsors must adapt their IT-systems, processes and documentation. Regulated investors usually have - apart from money market funds - higher capital charges. The same applies to the sponsoring banks for the position of the ABCP liquidity lines. This applies in particular if a STS status is not achieved. Even with STS at transaction level, this can at best be mitigated.

And what do we have on the positive side? There is little to report here for ABCP financing for the real economy. Conflicts of interests and transparency issues have never been a major point. And the performance of the transactions has also demonstrably never suffered - even not during the financial market.

In this respect, the EU securitisation regulation with regard to ABCP must unfortunately be described as a missed opportunity. Nevertheless, markets will adapt and ABCP financing will continue - perhaps in a different form and with different approaches. Capital markets have always proven their ability to adapt and the new hierarchy methodology opens up securitisation opportunities for real economic receivables even outside ABCP structures. In this respect, we can look forward to further developments.