

Group Briefing

May 2018

The Impact of the Securitisation Regulation on UCITS and AIFMs

Ireland Client Service Law Firm of the Year 2018
Chambers Europe Awards

Ireland Law Firm of the Year 2018
International Financial Law Review (IFLR)
Europe Awards

Advised on Equity Deal of the Year 2018 – Allied Irish Banks IPO
International Financial Law Review (IFLR)
Europe Awards

Finance Dublin Awards 2018
Arthur Cox advised on 13 Deals of the Year awarded by Finance Dublin.

Ireland Law Firm of the Year 2017
Chambers Europe Awards

Best Firm in Ireland 2016 & 2017
Europe Women in Business Law Awards

Best National Firm for Women in Business Law 2016 & 2017
Europe Women in Business Law Awards

Best National Firm Mentoring Programme 2016 & 2017
Europe Women in Business Law Awards

Ireland Law Firm of the Year 2016
International Financial Law Review (IFLR)
Europe Awards

Ireland Law Firm of the Year 2016
Who's Who Legal

Americas International Tax Firm of the Year 2016
International Tax Review

Advised on the 'Deal of the Decade' – Merger of Lafarge and Holcim
Mergermarket European M&A Awards

The Securitisation Regulation (Regulation EU 2017/2401) came into force on 17 January 2018 and will be directly applicable across the EU from 1 January 2019. In this briefing we highlight some of its key provisions insofar as they impact UCITS and AIFMs.

THE NEW FRAMEWORK AND ITS APPLICATION

The Securitisation Regulation replaces the existing sector-specific approach to securitisation regulation with a new set of rules that apply to all European securitisations. Currently what determines which set of securitisation rules apply depends on the type of investor. For example, the securitisation provisions for AIFMs are those in Article 17 of AIFMD (Directive 2011/61/EU) and apply to EU AIFMs managing or marketing EU or non-EU AIFs (but do not currently apply to non-EU AIFMs managing or marketing EU or non-EU AIFs because the delegated acts contemplated in the transitional provisions have not been adopted). However, currently there are no corresponding securitisation provisions in the UCITS Directive (Directive 2009/65/EC). This anomaly whereby UCITS are not currently subject to due diligence, transparency and risk

retention requirements with respect to investments made in securitisations has been rectified in the Securitisation Regulation. The new due diligence requirements apply to all "institutional investors", which is defined to include AIFMs and UCITS (and credit institutions, investment firms, insurers and reinsurers).

DEFINITION OF SECURITISATION

The definition of "securitisation" is intended to capture any transaction or scheme where the credit risk associated with an exposure or a pool of exposures is tranching. Essentially, the definition includes any investment with tranches or classes where payments in the transaction or scheme are dependent on the performance of the exposure or of the pool of exposures and the participation in losses differs between the tranches during the life of the transaction or scheme. These types of investments are treated differently

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from notes or debt securities that may have classes that reflect differing terms (like payment dates or interest rates). Analysis will need to be done on a case by case basis to determine if a particular investment falls within the scope of the definition of securitisation in the Securitisation Regulation.

RISK RETENTION

Institutional investors must ensure that the originator, sponsor or original lender of a securitisation retains at least a 5% net economic interest in the securitisation. The new rules also impose direct risk retention requirements on the securitising entities themselves which complement the existing rules on the institutional investors. This means that an EU securitising entity needs to satisfy the new requirements even where there is no requirement for investors to do so, for example, because the investors are non-EU entities. This marks a shift from the current rules which place an indirect obligation on EU institutional investors to ensure that EU risk retention requirements are met before investing in a securitisation. This new “direct approach” is intended to complement the existing due diligence requirements on institutional investors to verify before investing whether or not the securitising entity has retained risk. As a consequence the new direct approach requires securitising entities established in the EU to retain risk even if the investors are located outside of the EU and are not institutional investors.

DUE DILIGENCE

Institutional investors must undertake due diligence processes before becoming exposed to a securitisation and on an ongoing basis as long as they remain exposed to a securitisation.

The new regime requires an institutional investor to:

1. make certain verifications before becoming exposed to a securitisation including that the structure is risk retention compliant with the originator retaining a material net

economic interest of not less than 5% in the securitisation; that the assets were originated on the basis of certain credit-granting standards and that the securitising entity complies with its disclosure obligations;

2. carry out a due diligence assessment which enables it to assess the risks involved before becoming exposed to a securitisation in relation to the exposures underlying the securitisation and the structural features of the securitisation;
3. on an ongoing basis during the life of the securitisation establish written procedures proportionate to the risk profile of the securitisation position and institutional investor's trading position to monitor the performance of the securitisation and its underlying exposures, perform stress tests, ensure there is an adequate level of internal reporting of material risks and be able to demonstrate that they have a comprehensive and thorough understanding of the securitisation position and its underlying exposures.

These rules will mean that portfolio managers of UCITS and AIFMs will need to conduct due diligence before an investment is made in a securitisation position and continue to perform due diligence during the period the investment continues in a securitisation.

TRANSPARENCY

Originators must make available to holders of a securitisation position certain information on the transaction and underlying exposures within investor reports and if they breach their risk retention obligations they may be subject to administrative and possibly criminal sanctions.

APPLICATION TO UCITS AND AIFMS

The current due diligence, transparency and risk retention provisions in AIFMD are to be repealed and replaced by a single article stating that where AIFMs are exposed to securitisation positions

which do not meet the requirements of the Securitisation Regulation the AIFM shall “in the best interests of the investors in the relevant AIFs, act and take corrective action, if appropriate”. This appears to contemplate different measures that could be taken by an AIFM or UCITS, not just a disposal of interests in the securitisation.

The existing Article 17 of AIFMD specifically refers to the delegated acts in the transitional provisions for non-EU AIFMs managing or marketing EU and non-EU AIFs which are not yet in force. In the definition of “institutional investor” in the Securitisation Regulation no distinction is made between an AIFM subject to the full scope of AIFMD and non-EU AIFMs as it refers to the definition of an AIFM being a legal person who manages one or more AIFs. There is a question as to how these new securitisation rules can be extended to apply to non-EU AIFMs. However, given that the transitional provisions for non-EU AIFMs are still in force and no delegated acts have been adopted and the fact that the new Article 17 does not expressly refer to the rule applying to non-EU AIFMs, arguably a view can be taken that the new rules do not apply to non-EU AIFMs. It is hoped that this will be clarified in the technical standards and / or guidance issued in advance of the new regime coming into effect.

Similarly, Article 50a of the UCITS Directive is replaced with a new provision stating that where UCITS are exposed to securitisation positions which do not meet the requirements of the Securitisation Regulation the UCITS shall “in the best interests of the investors in the relevant UCITS, act and take corrective action”.

GRANDFATHERING / TRANSITIONAL PROVISIONS

The Securitisation Regulation applies to securitisations the securities of which are issued on or after 1 January 2019 or which create new securitisation positions on or after that date. Pre-existing securitisations will be required

to continue to apply the rules in place immediately prior to the effective date of the Securitisation Regulation unless new securities are issued or new positions created.

NEXT STEPS

The European Supervisory Authorities are consulting on a draft technical standards to provide details on how the legislation will be implemented and we will keep you updated on future developments in relation to this.

If you would like to discuss the requirements under the Securitisation Regulation, please feel free to contact a member of our team.

KEY CONTACTS



KEVIN MURPHY

PARTNER, CO-HEAD
+353 1 920 1177
kevin.murphy@arthurcox.com



TARA O'REILLY

PARTNER, CO-HEAD
+353 1 920 1787
tara.oreilly@arthurcox.com



SARAH CUNNIFF

PARTNER
+353 1 920 1171
sarah.cunniff@arthurcox.com



DARA HARRINGTON

PARTNER
+353 1 920 1206
dara.harrington@arthurcox.com



CORMAC COMMINS

PARTNER
+353 1 920 1786
cormac.commins@arthurcox.com



IAN DILLON

+353 1 920 1788
ian.dillon@arthurcox.com

arthurcox.com

Dublin
+353 1 920 1000
dublin@arthurcox.com

Belfast
+44 28 9023 0007
belfast@arthurcox.com

London
+44 207 832 0200
london@arthurcox.com

New York
+1 212 782 3294
newyork@arthurcox.com

Silicon Valley
+1 650 943 2330
siliconvalley@arthurcox.com