Group Briefing

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What you need to know about the new EU Securitisation Regulation

The new EU Securitisation Regulation will apply from 1 January 2019. It will significantly reform the EU securitisation market, and will introduce a framework for "*simple, transparent and standardised*" (**STS**) securitisations.

This briefing sets out what you need to know about the reforms that the new Securitisation Regulation will introduce. We are publishing a separate briefing that focuses on what you need to know about the new STS securitisation framework.

BACKGROUND

Almost two years after the European Commission published its proposals to reform the EU securitisation market, and following lengthy negotiations, provisional agreement was finally reached between the Commission, the EU Council and the European Parliament on 30 May 2017 on the proposed new Securitisation Regulation, and related amendments to the Capital Requirements Regulation. For more information, read our briefing: Securitisation Reform: Agreement reached.

Both Regulations were then published in the Official Journal in December 2017. They will apply from 1 January 2019.

SCOPE

Until now, securitisation rules have been set out in different pieces of legislation, such as the Capital Requirements Regulation, the Alternative Investment Fund Managers Directive, and the Solvency II Delegated Act. The new rules will apply in a harmonised manner to all securitisations, securitising entities, and EU-regulated institutional investors.

The new Securitisation Regulation and the amendments to the Capital Requirements Regulation will apply to securitisations where the securities are issued on or after 1 January 2019, and to securitisations that create new securitisation positions after 1 January 2019. Pre-existing securitisations will, in general, remain subject to the current rules (unless new securitisation positions are created on or after 1 January 2019).

For further details on the implications of the new Securitisation Regulation for AIFMs and UCITS, read the recent briefing by our Asset Management and

Investment Funds Group: The Impact of the Securitisation Regulation on UCITS and AIFMs.

WILL THE DEFINITION OF "SECURITISATION" CHANGE?

The definition of "**securitisation**" in the new Securitisation Regulation is largely unchanged from that currently contained in the Capital Requirements Regulation, save for the addition of a new limb which confirms that a transaction that creates a "*specialised lending exposure*" is not treated as a securitisation.

KEY PRACTICAL IMPLICATIONS

The most notable aspects of the new Securitisation Regulation relate to:

» credit-granting criteria

» risk retention

» transparency

» due diligence

CREDIT-GRANTING CRITERIA

A securitising entity:

» will be required to apply the same credit-granting criteria to exposures that are to be securitised as it does to exposures that are not to be securitised,

» must ensure that those criteria are "*sound and well-defined*", and

» have "*effective systems in place to apply those criteria and processes to ensure that the credit-granting is based on a thorough assessment of the obligor's credit-worthiness*".

If an originator purchases exposures of an original lender which were originated after 20 March 2014, with a view to securitising them, the originator will also need to check that the original lender's credit-granting criteria complied with the above general requirements.

Securitisation of self-certified mortgages originated after 20 March 2014 (when the Mortgage Credit Directive came into force) will be prohibited.

RISK RETENTION

The risk retention level will remain at 5%, and the five retention methods will not change.

The existing '*indirect approach*' to ensuring compliance with the retention requirements remains (i.e. the obligation on institutional investors to check that the retention requirements have been met), while a new '*direct approach*' will also apply.

The new '*direct approach*' is a notable change, creating a direct obligation on originators, sponsors and original lenders to comply with the retention requirements, even if the investors are not established in the EU, and even if the investors are EU institutional investors who will also be required to verify compliance with the retention requirements.

If multiple entities could be subject to the direct obligation by virtue of being an originator, sponsor or original lender, they will need to agree the allocation of responsibility between themselves. In the absence of agreement, responsibility will rest with the originator.

The definition of "**originator**" has been tightened so that only an entity of substance can act as originator, to ensure that the retention requirements cannot be satisfied by using an SPV whose sole purpose is to securitise exposures

The new Securitisation Regulation also prohibits an originator from deliberately selecting assets for securitisation on the basis that they are more likely to suffer losses than the assets that the originator will retain on its balance sheet for the same period.

TRANSPARENCY

Creating new securitisation positions after 1 January 2019 will trigger the application of the transparency requirements under the new Securitisation Regulation.

Originators, sponsors and securitisation special purpose entities (**SSPEs**) will be required to make detailed information available to holders of securitisation positons, competent authorities and (upon request) potential investors.

The disclosure requirements are more onerous than those currently contained in the Capital Requirements Regulation, and are more aligned with what was envisaged by Article 8b of the Credit Rating Agencies Regulation.

The information to be disclosed must include loan level data, all transaction documents, the prospectus (or deal summary where there is no requirement for a prospectus), and investor reports (including retention details). There are additional disclosure requirements in respect of STS securitisations, which are covered in our briefing on the STS securitisation framework.

Much of the above information must be provided before pricing. Loan level data and investor reports must be disclosed quarterly (or monthly for asset-backed commercial paper transactions).

Any inside information relating to the securitisation that the originator, sponsor or SSPE is obliged to make public under the Market Abuse Regulation, and any material breach of the transaction documents (including details of any related remedy, waiver or consent) must be disclosed without delay, as must any material changes to the transaction documents.

The originator, sponsor and SSPE must agree between themselves who is responsible for meeting the disclosure obligations, and that party must disclose the information via a "**securitisation repository**" (or, if there is no securitisation repository, via a website that meets certain conditions).

ESMA was mandated to develop Level 2 measures, setting out the finer detail of the information that must be disclosed. ESMA's Final Report, containing its final draft Level 2 measures on the detailed requirements for the disclosure of loan level data and investor reports, and setting out standardised disclosure templates, is here, and is currently with the Commission for approval.

In respect of private securitisations

(i.e. a securitisation in respect of which no prospectus is required) there is no requirement to disclose the above information via a securitisation repository or website, but it must still be disclosed on a bilateral basis.

DUE DILIGENCE

The due diligence obligations of "**institutional investors**" (i.e. credit institutions, investment firms, insurers, reinsurers, alternative investment fund managers (**AIFMs**), pension funds, investment managers or authorised entities appointed by pension funds, UCITS management companies, and internally-managed UCITS) will all be contained in the new Securitisation Regulation. Many of these requirements are very similar to those that already apply to credit institutions, investment firms, insurers, reinsurers and AIFMs under sector-specific legislation.

» **Verification**

Before holding a securitisation position, an institutional investor must verify compliance by the originator/original lender with the credit-granting criteria referred to above where the originator/original lender is established in a third country, or is established in the EU but is not a credit institution or investment firm. There is no requirement on an institutional investor to verify matters relating to credit-granting where the originator/original lender is an EU credit institution or an EU investment firm.

An institutional investor must also check that the retention requirement has been met, that the retention has been disclosed, and that the originator, sponsor or SSPE (as applicable) has complied with the transparency requirements.

» **Due Diligence Assessment**

Prior to holding a securitisation position, an institutional investor must carry out a due diligence assessment which enables it to assess the risks involved by considering, at a minimum, the risk profile of the securitisation position and the underlying exposures, and the structural features of the securitisation that could materially impact performance.

» **Written Procedures**

An institutional investor must also have written procedures in place to monitor compliance with its verification and due diligence obligations, and to monitor the performance of the securitisation position and the underlying exposures.

While the due diligence obligations apply to EU-based regulated entities, an out-of-scope investor could still decide to diligence a securitisation to ensure that the requirements of the EU securitisation regime regarding credit-granting, retention and disclosure are being met.

OTHER KEY POINTS

Ban on Re-Securitisation

Subject to limited exceptions, the new Securitisation Regulation prohibits the creation of securitisations which include securitisation positions in their pool of underlying exposures. This prohibition does not affect securitisations where the securities are issued prior to 1 January 2019.

Sales to Retail Investors

The new Securitisation Regulation also restricts sales of securitisation positions to MiFID II retail clients unless a MiFID II-compliant suitability test has been carried out by the seller on the client, and a number of other conditions have been met.

NEXT STEPS

The EBA has drafted Level 2 measures relating to the risk retention requirement (the EBA's final draft is here), and ESMA has developed Level 2 measures relating to the detailed requirements for the disclosure of both loan level data and investor reports, including standardised disclosure templates (ESMA's Final Report is here). These drafts are with the Commission for approval. We will issue further updates as these measures are finalised.

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