Group Briefing
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Securitisation Regulation: *Risk Retention Summary*

The new EU Securitisation Regulation will apply across the EU from 1 January 2019. In this briefing, we highlight the key changes to the risk retention regime that are being introduced.

Draft Regulatory Technical Standards relating to the new risk retention requirements (the **Level 2 RTS**) were published by the European Banking Authority on 31 July 2018. It is not yet known when the European Commission will adopt them and, therefore, when they will enter into force.

WHAT'S STAYING THE SAME?

Level of retention

Both the current and the new risk retention requirements set the level of retention at 5%.

Eligible retainers

The retention will need to be held by a suitable entity or entities – the "**originator**", "**sponsor**" or "**original lender**".

Restrictions

No credit-risk mitigation, hedging or sale of the retained interest (except in the case of insolvency of the retainer).

Modalities of retention

The most common being:

» retention of the first loss tranche, and

» retention of not less than 5% of the nominal value of each of the tranches sold or transferred to investors.

WHAT'S CHANGING?

One legislative regime

The risk retention requirements will be in one harmonised legislative regime – the new Securitisation Regulation and the (currently draft) Level 2 RTS, rather than being set out in different pieces of legislation.

Increased scope (institutional investors)

Whereas before only certain regulated entities were caught under their specific prudential legislation, and required to check that the retention requirements had been met (known as the '*indirect*' approach), the retention requirements (and that '*indirect*' approach) will apply

to a wider universe of institutional investors (insurance and reinsurance undertakings, certain IORPs and their investment managers, AIFMs, UCITS management companies and internally managed UCITS, credit institutions and investment/MiFID firms).

Direct retention obligation

There will be a '*direct*' obligation on the retainer to comply with the retention requirements (this is in addition to the continuing '*indirect*' approach).

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

Amendments to the definitions of sponsor, originator and original lender

- The definition of "**sponsor**" has been widened from that used in the Capital Requirements Regulation to specifically include credit institutions, whether or not located in the EU, and investment firms as defined in MiFID II. The MiFID II definition of "**investment firm**" is not limited by jurisdiction so it appears that non-EU asset managers may also act as sponsors, although the position is not certain and clarity on that point from the European Supervisory Authorities would be welcome.
- The Level 2 RTS introduce new legislative requirements to be met in order for entities to qualify as originators. These relate to matters such as business strategy, funding streams and corporate governance. This links to the tightening of the definition of "**originator**" to ensure that only an entity of substance can act as an originator.
- "**Original lender**" is now defined as "*an entity which, itself or through related entities, directly or indirectly, concluded the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposures being securitised.*"

New transparency/disclosure requirements relating to risk retention

The retainer will be required to disclose certain prescribed information regarding its retention to investors, including what type of retainer entity it is and what retention method has been adopted.

IMPACT OF NON-RISK RETENTION COMPLIANT SECURITISATIONS

Retainers

Where a retainer is a regulated entity its existing competent authority will supervise compliance with the risk retention requirements. In the case of unregulated retainers, Member States must appoint a competent authority to supervise compliance.

Member States must lay down rules establishing appropriate administrative sanctions and remedial measures in the case of ***negligent or intentional*** infringement by retainers of the risk retention requirements. These sanctions and measures must be effective, proportionate and dissuasive and will include the ability to impose financial sanctions.

Investors

For credit institutions, MiFID firms and insurance and reinsurance undertakings, exposures to non-risk retention compliant securitisations may result in capital risk weights.

For AIFMs and UCITS they must take corrective action (if appropriate) if exposed to a non-risk retention compliant securitisation.

No specific remedial actions have been specified for IORPs as of yet.

NEXT STEPS

We will issue further updates once the Level 2 RTS are adopted by the European Commission.

FURTHER INFORMATION

For further information on the new Securitisation Regulation, read our recent briefings:

- What you need to know about the new EU Securitisation Regulation
- Simple, Transparent and Standardised (STS) Securitisations: What you need to know
- Securitisation Regulation Update: Addressing Challenges

For further information on the impact of the new Securitisation Regulation on UCITS and AIFMs, read the briefing by our Asset Management and Investment Funds Group: The Impact of the Securitisation Regulation on UCITS and AIFMs.

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