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European Supervisory Authorities Make Recommendations for the EU Securitisation Market

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Background

Article 44 of the EU's Securitisation Regulation ("SECR")[1] requires the Joint Committee of the European Supervisory Authorities[2] ("ESAs") to produce a report every three years on: (a) the implementation of requirements for simple, transparent and standardised securitisations ("STS"); (b) competent authorities' actions on material risks, new vulnerabilities and market participants' efforts to further standardise securitisation documentation; (c) the functioning of due diligence and transparency requirements and whether transparency enables sufficient regulatory oversight; and (d) compliance and "modalities" of the risk retention requirement.

On 31 March 2025, the ESAs published the most recent report (the "Report"), which is the result of a 2024 consultation and represents the final recommendations of the ESAs for the preceding three-year period.

With one eye on an emphasis on the urgent need to revive the European securitisation market (which lags considerably behind that of the US) and which emphasis is made clear in the reports of Christian Noyer, Enrico Letta and Mario Draghi, and the other eye on investor protection and the need for market stability, the Report sets out a number of recommendations, some of which have potentially unhelpful consequences.

As of now, the status of the recommendations is varied. Certain recommendations include guidance which appears to have immediate effect, whereas others would require amendments to SECR which will entail a full legislative process in order to take effect.

[1] Regulation (EU) 2017/2402

[2] The Joint Committee of the ESAs is made up of the European Banking Authority, the European Insurance and Occupational Pensions Authority, and the European Securities and Markets Authority.

Below, we cover certain of the recommendations set out in the Report, each by reference to their current position in the SECR, with a focus on those that are more likely to have more impact on securitisation market participants.

1. Jurisdictional Scope

Current Position	ESAs' Recommendation
SECR Articles 5 to 7 and 9 (due diligence, risk retention, transparency and criteria for credit granting). Affected EU investors should verify, regardless of the location of the sell-side, and EU sell-side parties are subject to the requirements directly.	Insertion of a clarification into Article 1 of SECR to the effect that where: (a) at least one of the sell-side parties is established in the EU – buy-side may be established within or without the EU: sell-side complies; (b) at least one buy-side party is in the EU – sell-side may be established within or without the EU: buy-side complies.

While this does not represent a departure from existing requirements, this is useful clarification that sell-side parties established outside the EU but with an EU-based investor will have to comply indirectly with certain requirements, including risk retention and transparency, in order for that EU-based investor to meet verification obligations.

2. Definitions of "Public Securitisation" and "Private Securitisation"

Current Position	ESAs' Recommendation
To be "public" would need the transaction to require a prospectus to be prepared under the Prospectus Regulation[3] (i.e. when an offer to the public was being made or the securities have been admitted to trading on a regulated market).	"Public securitisation" is defined as having any of the following features: (a) a prospectus is required under the Prospectus Regulation; (b) notes are admitted to trading on any EU trading venue; or (c) marketed to a broad range of investors on a non-negotiable basis.

[3] The Prospectus Regulation repealed and replaced the Prospectus Directive.

This proposal emanates from a concern that a number of securitisations that are "public" in substance have been mischaracterised as private. However, the proposed new definition is broad and runs the risk of capturing securitisations that are generally considered private.

While the Report contemplates CLOs and certain synthetic securitisations, the trading aspect of the proposed definition would likely also capture other private securitisations such as warehouse financings, which may be listed and admitted to trading on EU exchanges for tax, liquidity and capital adequacy purposes rather than for the purposes of public distribution. The main effect of being categorised as "public" for SECR purposes is that it creates an obligation to report to Securitisation Repositories (though this may come into effect for private securitisations in any event (see section 7 (*Transparency Framework*) below).

In response to concerns around this, the ESAs have declined to enhance the definition of private securitisation.

We note that the UK, for the time being at least, has opted not to adjust existing definitions of public and private securitisations.

3. Definition of "Securitisation"

Current Position	ESAs' Recommendation
SECR Article 2(1)	No change

While the ESAs acknowledge that market developments such as "single tranche securitisations" and "credit funds" have presented some ambiguities around this definition, the need to remain aligned with international standards and prudential rules means that there should be no change at present to the definition of "securitisation". The ESAs also emphasise the need to for the scope to remain wide so as to capture the essence of securitisation transactions, being those exhibiting the tranching of the credit risk associated with an exposure or pool of exposures.

4. Due Diligence Rules

Current Position	ESAs' Recommendation
SECR Article 5 requires all institutional investors to conduct due diligence to ensure: (a) sound and well-defined criteria and processes are applied to credit-granting; (b) compliance with risk retention	A comprehensive reform of SECR Article 5 proposes:

requirements; and (c) compliance with transparency obligations. Article 5(1)(e) requires investor verification regardless of where the sell-side is located. Article 5(3)(c) institutional investors may rely "*to an appropriate extent*" on STS notifications and disclosures, but "*without solely or mechanistically relying on that information or information.*" SECR Recital 9 states that it is "*essential that institutional investors be subject to proportionate due-diligence requirements ensuring that they properly assess the risks arising from all types of securitisations, to the benefit of end investors.*" SECR Recital 33 states that "*Investors should perform their own due diligence on investments commensurate with the risks involved*". The sanctions for non-compliance under SECR Article 32 are not directly applicable to investors.	• avoiding cross-references to other provisions in SECR, including Articles 7 and 9; • providing a list of "necessary information"; • focus on the substance rather than the form of the information; • institutional investors required to: (a) verify access to key information; (b) check sufficiency of information for risk assessment purposes; and (c) confirm that the sell-side will provide all necessary information throughout the life of the transaction; • differing sufficiency of information requirements based on risk profile of investment position and repeat transactions/programmes; • disclosure of compliance with riskretention compliance need not be in template form; • timing of documentation of due diligence on secondary markets should be done within a reasonable period of time not exceeding 15 calendar days; • removal of the requirement for investors to verify STS status; • recasting of ability to delegate due diligence obligations and expanding Article 32 sanctions to apply to investors for infringement of Article 5 due diligence requirements.

The ESAs have identified that, while SECR does discuss proportionality and commensurate due diligence, it gives no guidance as to how and with what metrics these concepts are to be achieved. Similarly, for STS deals, "appropriate extent" is not elaborated on. Given the equivalence of due diligence requirements in a number of non-EU jurisdictions, including the UK, this is a disproportionate, time-consuming and costly exercise.

In order to meet these concerns, which the ESAs acknowledge, the proposal is to reform due diligence obligations to introduce true proportionality and clarity of regulatory expectations. This means a move away from a reliance on template disclosures and concentration on the substance of the disclosures matching the risk profile of the investment.

The proposed move to a more principles-based investor due diligence requirement is welcome, and would align the EU rules with those currently applicable in the UK in that template format reporting would not be required for securitisations when the sell-side parties are located outside of the EU. However, the proposal is that the content of information provided should remain "substantially the same" as what would be required under SECR Article 7 (including, as that may be amended, as further discussed at section 7 (*Transparency Framework*)).

Further detail is also included on the impact of the risk position of different investors in relation to the sufficiency of information they should receive, with examples of seniority of tranching, structural features impacting amortisation profiles of tranches and whether the transaction is repeat in nature or part of a programme issuance. The ESAs recommend being mandated to develop technical standards or guidelines to provide more detail on these terms.

For STS securitisations, the ESAs recommend removing the requirement for investors to check compliance with the relevant STS criteria on the basis that originators are already required to ensure compliance. However, this would be subject to the enhanced supervision of originators and/or verification parties.

5. STS Framework

Current Position	ESAs' Recommendation
SECR Chapter 4	The ESAs make no recommendation (either way) on extending STS to unfunded guarantees by credit institutions and reinsurers. Removal of risk retention and transparency requests (as need to be satisfied anyway).

	Targeted recommendations for STS criteria (on balance sheet) include: • permitted removals of underlying exposures to include sanctions/objectionable practices, and changes to national law that affect enforceability of underlying exposures; and • the rules on allocation of losses and amortisation should be amended to allow the loss-bearing capacity of junior tranches.

Given the growth in the market for STS synthetic transactions, the ESAs see no need for a wholesale reform of the STS framework. Instead, the focus is once again on revisions providing clarity, consistency and proportionality.

6. Risk Retention Rules

Current Position	ESAs' Recommendation
SECR Article 6: obligation on the originator, sponsor or original lender to maintain a material net interest of not less than 5%. "*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.*" EU recast risk retention RTS [4] Article 2(7)(a) ("RTS") provides as a qualification for the sole purpose test that "*the entity has a strategy and the capacity to meet payment obligations consistent with a broader business model that involves material support from capital, assets, fees or other*	"Predominant" revenues as used in the RTS should be understood as meaning more than 50% (i.e. revenues of an entity should correspond to no more than 50% on exposures to be securitised, risk-retained assets, or any corresponding income from these two exposures). The European Commission should explore broadening the definition of "sponsor" to include other regulated entities, including CLO managers established outside the EU. No change to 5% minimum risk retention requirement.

4 Delegated regulation - EU - 2023/2175 - EN - EUR-Lex

sources of income, by virtue of which the entity does not rely on the exposures to be securitised, on any interests retained or proposed to be retained in accordance with this Regulation or on any corresponding income from such exposures and interests ***as its sole or predominant source of revenue*.” SECR Article 2(5) defines “sponsor” as being either a credit institution or an investment firm.	Clarification for sponsors of ABCP programmes to be considered sponsor at transaction level.

Feedback from EU competent authorities has led to certain ESAs’ concerns that the use of third-party origination vehicles in CLO transactions in order to comply with risk retention obligations is not in line with the original intention behind the sole purpose test, given that these vehicles are funded by third-party-investors and are “special purpose entities” with revenues predominantly derived from securitised assets or assets subsequently securitised.

The ESAs acknowledges ambiguities around the term “predominant”, and its consequential effect on determining the sole purpose test. Seeking to clarify the position, the Report includes an interpretation by the ESAs to the effect that a threshold requirement applies such that no more than 50% of an entity’s revenue should be derived from exposures to be securitised or risk retained assets. This interpretation also applies immediately: “*[I]t is supervisors' view that going forward, any new issuance should apply this interpretation”.*

In connection with this:

- since the date of the Report, we understand that the ESAs have given indications that in price-to-close transactions that are not currently “issued”, investors should consult with their local (EU) supervisory authority as to whether such transactions are required to apply this new interpretation (though we understand at least one such authority has indicated that these should be grandfathered as though issued prior to the date of the Report);

- the ESAs’ interpretation, while seemingly focused on CLOs, looks to extend beyond that to other securitisation structures, and while we cannot be certain of the intended scope, appears to apply this predominant revenue test independently of the other aspects of the sole purposes test set out in the RTS; and

- the market has reacted to this significant and immediate intervention by assessing the extent to which current risk retainers are likely to meet this requirement and, where necessary, making adjustments and/or moving to alternative structures.

The ESAs' recommendation that the definition of "sponsor" be expanded to capture regulated entities other than credit institutions, including non-EU established CLO managers, should assist in making the manager-retention holder raise a more viable option for CLOs in the future (though some form of sole purpose test may still apply to such entities).

7. Transparency Framework

Current Position	ESAs' Recommendation
SECR Article 7 – sets out the minimum information to be disclosed to investors, potential investors (on request) and competent authorities. EU sell-side parties are obliged to provide and EU buy-side parties are required to check that transaction and collateral level reporting for all securitisations is provided in ESMA reporting template format. Reporting information delivery to Securitisation Repositories only for "public" securitisations.	Streamline current templates for public securitisations. Simplify templates for private securitisations. Obtain feedback on mandatory reporting of private transactions to securitisation repositories (data to remain non-public). Introduce certain disclosure exemptions.

Again, the ESAs are focusing on proportionality, as well as the utility of the disclosures. When reviewing whether reporting templates are fit for purpose, the feedback has been resoundingly negative, and the ESAs propose to deal with this by:

- adjusting the underlying documents required depending on the type of securitisation transaction;
- harmonising and simplifying transaction-level reporting by considerably reducing the number of data fields;
- establishing a new "Asset-class Section" that encompasses asset-class information currently reported through collateral-level information and relevant transaction-level information;

- recognising that different assets require different approaches by stratifying loan level data, allowing for an aggregated reporting approach linked to data points/criteria for asset classes that are (a) revolving, (b) highly granular or (c) of short-term maturity;

- introduce an intra-group exemption from disclosures when no third-party investor is involved;

- clarifying the conditions under which reporting obligations may be delegated to third parties; and

- requiring reporting of private deals to securities repositories. Third county securitisations would not be subject to this obligation. Consideration is given by the EU to the non-public nature of data (this will be key given the breadth of transactions captured by the definition of (private) securitisation).

The ESAs acknowledge that implementing this overhaul of the reporting regime could result in a longer implementation timeline compared to simply refining reporting templates for public transactions. So even if the EC accepts these recommendations, which we view as generally helpful, any changes would take some time to implement (by both amendments to the SECR itself and the preparation of technical standards providing further detail and the format of new templates for reporting).

If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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