

# Clients & Friends Memo

## The EBA Publish Final Draft RTS Relating to Risk Retention Under the EU Securitisation Regulation

26 April 2022

### Background

On 12 April 2022, the European Banking Authority (the “**EBA**”) announced the publication of its [final draft Regulatory Technical Standards](#) (“**RTS**”) specifying the requirements for originators, sponsors and original lenders in relation to risk retention. Regulation (EU) 2017/2402, as amended (the “**Securitisation Regulation**”), established the requirements concerning the retention of a material net economic interest in securitisations and empowered the EBA to prepare draft RTS in this area. There has been a long wait for these final drafts, given the EBA submitted an initial version to the European Commission in July 2018 (the “**2018 RTS**”), and then consulted on further changes in June 2021.

### The Final Draft RTS

The final draft RTS provide detail on the following aspects of the risk retention requirement:

- a. requirements on the modalities of retaining risk;
- b. the measurement of the level of retention;
- c. the prohibition of hedging or selling the retained interest;
- d. the conditions for retention on a consolidated basis;
- e. the conditions for exempting transactions based on a clear, transparent and accessible index;
- f. the modalities of retaining risk in case of traditional securitisations of non-performing exposures; and
- g. the impact of fees paid to the retainer on the effective material net economic interest.

Amendments have been made to the 2018 RTS in order to provide greater consistency with the mandate as set out in Article 6 of the Securitisation Regulation. The most pertinent changes are:

1. In order to align the provisions of the final draft RTS more closely with the mandate in the Securitisation Regulation, specific cases of exposure to the credit risk of a securitisation position by credit derivative counterparties and liquidity facility providers under the previous Article 2, and conditions that holdings of securitisation positions by

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subsidiaries in third countries had to meet under the previous Article 2 to be considered as not in breach of the due diligence obligations in Article 5 of the Securitisation Regulation have been deleted.

2. Amendments have been made to the initial disclosure requirements on the level of the commitment to retain a material net economic interest in the securitisation (previously Article 15). Both the Article and the corresponding Recital have been deleted as there is now overlap with the Delegated Regulation (EU) 2020/1224 on disclosure under Article 7 of the Securitisation Regulation. The obligation on the retainer to make and disclose a commitment to investors to maintain a material net economic interest in the securitisation on an on-going basis has been retained, as this obligation is not included in the Delegated Regulation.
3. The final draft RTS provide guidance on the ban on originators cherry-picking assets, including criteria for determining comparable assets, and on the focus of the assessment of the relevant national regulator.

New provisions have been included in the final draft RTS to take into account the expanded mandate of the EBA on risk retention under Article 6 of Securitisation Regulation following amendments made as part of the legislative measures in the 2021 Capital Markets Recovery Package. These include addressing the issues of (i) the modalities of risk retention in traditional non-performing exposure ("**NPE**") securitisations, (ii) the impact of fees payable to retainers on the risk retention requirement, (iii) the expertise of the servicer in NPE securitisations, (iv) clarification of the synthetic excess spread, (v) retention in re-securitisations, and (vi) own issued debt instruments. The key points include:

1. The final draft RTS set out how to apply the risk retention options on NPE securitisations, referencing the net value of non-performing exposures. The alternative options for retaining a net economic interest (point (a) of Article 6(3) of the Securitisation Regulation) should be included in the application of the net value approach to the securitised exposures qualifying as "non-performing exposures".
2. The final draft RTS clarify the requirements for the fees payable to the retainer to comply with the risk retention requirements. The requirements are not limited purely to NPE securitisations. The phrase "fees paid to the retainer" refers to the servicer acting as retainer in both NPE securitisations and performing securitisations, insofar as applicable. The definition for "fees" is "any remuneration payable to the retainer where the retainer acts in any additional capacity as service provider to the securitisation". The term "impact" is defined as "referring to both the amount and structure of the fees payable to the retainer where the amount and/or structure of the fees would undermine the 'effectiveness' of the risk retention requirement". Recital (6) of the final draft RTS establishes that the retained material net economic interest should not be prioritised in terms of cash flows to preferentially benefit from being repaid or amortised. Taking into account the general principle that service providers are usually paid before the holders of the securitisation positions, the fees payable to the retainer in its role as the securitisation's service provider should not be set at an amount or structured in a way that undermines the retained material net economic interest. The EBA has also set out criteria in the case of fees which are paid on a priority basis. The fees must be set on an arm's length basis having regard to comparable transactions in the market and the fees must be structured as consideration for the relevant service without creating a preferential claim in respect of the cash flows of the securitisation which results in decreasing the retained interest.

3. The final draft RTS specify standards that the servicer in traditional NPE securitisations should meet to show it has the requisite expertise in the servicing of non-performing exposures. These standards align with the EBA guidelines on STS criteria for non-ABCP securitisation.
4. The final draft RTS recognise synthetic excess spread ("**SES**") as a form of compliance with the risk retention requirement by the originator of a synthetic securitisation provided it is subject to a capital requirement under the applicable prudential regulation. Article 6(1) of the Securitisation Regulation requires that any form of retention is measured at origination and retained on an ongoing basis thereafter. The exposure value of the SES should be treated as retained net economic interest and therefore the corresponding part of the net economic interest provided through the exposure value of the SES needs to be determined at origination and the commitment of SES has to be maintained on an on-going basis.
5. As a general rule, re-securitisations are prohibited by the Securitisation Regulation. Competent authorities may, however, authorise these transactions on a case-by-case basis. The final draft RTS give clarity on how the risk retention requirement applies in relation to these transactions and how this risk retention must be met separately for each of the securitisation and re-securitisation transactions. Importantly, the final draft RTS recognise an exception to this requirement. Where the originator acting as the retainer in the first securitisation(s) securitises exposures or positions retained in excess of the minimum net economic interest and no other exposures or positions are added to the pool of the re-securitisation, the retention for the first transaction should be considered sufficient.
6. The final draft RTS do not set out any further risk retention requirements for the securitisation of own liabilities since the EBA consider the existing requirements and guidance to be sufficient. Sell-side parties of a securitisation are also the debtors of the securitised own liabilities. Therefore a retention of a net economic interest in the securitisation would not add to the sell-side parties incentive to remain solvent and avoid a default on their liabilities.

In addition, the final RTS include technical changes made to the 2018 RTS. Two of these changes may be a particular interest to market participants:

1. The final draft RTS now provide an exhaustive list of exceptional circumstances under which a change of risk retention holder is permitted (such a change is generally prohibited by Article 6 of the Securitisation Regulation). Accordingly, the prohibition on the transfer of the retained economic interest will not apply: (a) in the event of the insolvency of the retainer; (b) when the retainer is, for legal reasons beyond its control and beyond the control of its shareholders, unable to continue acting in that capacity; or (c) in the case of retention on a consolidated basis in accordance with Article 14 [of the final draft RTS]<sup>1</sup>.
2. The Securitisation Regulation definition of originator specifies that an entity shall not, for the purposes of risk retention, be considered to be an originator where it has been

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<sup>1</sup> This refers to a scenario where a retention interest was held within a consolidated group and the retention interest is to be transferred to an affiliate to ensure that the retention is retained within that group.

established or operates for the “sole purpose” of securitising exposures. Article 2(7) of the final RTS has been amended from the 2018 RTS to modify the factors that should be taken into account when assessing whether such an entity meets the sole purpose test.

### **Next Steps**

If endorsed by the European Commission, the final draft RTS will be subject to scrutiny by the European Parliament and Council before the finalised text can be published in the Official Journal of the EU and enter into force on the twentieth day thereafter. It may be subject to further amendment before it is finalised and enters into force, although this is thought to be unlikely given the extended drafting process.

### **The UK Position**

Following its exit from the EU and the end of the Brexit transition period at the end of 2020, the UK has applied the “onshored” version of the Securitisation Regulation, which includes the same mandate in Article 6 for the development of technical standards on the risk retention requirement. The UK has previously announced that it will put forward its own technical standards in this area, in accordance with that mandate in the UK Securitisation Regulation. It is unclear when these standards will be announced, and the degree to which there will be divergence between the UK standards and the RTS developed in the EU.

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

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