Securitisation: Keeping it Simple?

1 October 2015

On 30 September 2015, the European Commission (the "**Commission**") published a proposal for a regulation (the "**Proposed Regulation**")[1] intended to harmonise existing EU laws applying to securitisations (including proposed changes to the EU risk retention rules) and to create a legal framework intended to encourage "simple, transparent and standardised securitisations" ("**STS securitisations**").

Background

One of the priorities of the Commission is to develop and integrate capital markets across the EU. This is with the purpose of reducing the dependence on bank funding, and with the intention of cutting the cost of raising capital, particularly for small and medium-sized enterprises ("**SMEs**"). The Commission wishes to create a Capital Markets Union - a single market for capital in the EU. An important way in which the EU can increase and diversify the sources of funding is to encourage securitisation. The EU recognises that securitisation can free up capital and so can improve the efficiency of the capital markets.

Whereas the US securitisation market has rebounded since the financial crisis of 2007-2008, the EU market has only partially recovered. It is in this context that the Commission wishes to take steps to put the legal framework in place that will encourage securitisation in the EU – especially through the use of STS securitisations.

The Proposed Regulation is part of a package of measures announced by the Commission on 30 September 2015 as part of its programme to build a Capital Markets Union. The Commission wants to encourage alternative sources of finance complementary to bank funding. Other measures published by the Commission include a proposal for the amendments of the Capital Requirements Regulation[2] (the "**CRR**") to reduce the capital requirements for exposures to STS securitisations (discussed below), proposed changes to the "Solvency II"

[1] Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation and amending Directives 2009/65/EC, 2009/138/EC, 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012

[2] Regulation (EU) 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012

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regime to make it easier for insurers to invest in infrastructure by reducing the capital to be held by insurers against debt and equity in qualifying infrastructure projects; and a consultation on venture capital to assess whether the existing EU regime can be modified so as to encourage greater investment in venture capital funds. Other initiatives being pursued by the Commission are proposals to move towards reducing the divergence in insolvency procedures across the EU and proposals to reform the Prospectus Directive[3] regime, in particular to streamline the prospectus requirements for SMEs.

Overview of the Proposed Regulation

One of the objectives of the Proposed Regulation is to create uniform definitions and regulations across financial sectors and to harmonise the rules on risk retention, due diligence and disclosure. It will therefore repeal the securitisation provisions that appear in a number of other EU legislative measures, such as the CRR, the Solvency II Directive (for insurers), and the UCITS[4] and AIFMD directives[5] (for fund managers), and replace them with common provisions.

Another objective of the Proposed Regulation is to define a category of securitisations which are simple, transparent and standardised. The risk retention, due diligence and disclosure requirements in the Proposed Regulation apply equally to STS securitisations and non-STS securitisations. However, as mentioned above, at the same time as publishing the Proposed Regulation, the Commission published a proposal for a regulation amending the CRR so that, for the purposes of the capital requirements of EU credit institutions and investment firms, lower risk weights will apply to exposures to STS securitisations.

Unlike the CRR the Solvency II Delegated Regulation[6] already differentiates between risk weightings that apply to securitisation investments according to whether or not the securitisations satisfy certain criteria set out therein. The Commission stated in its press release that, following the adoption of the Proposed Regulation, it intends to amend the Solvency II Delegated Regulation so that the criteria for differentiation therein are replaced by the STS securitisation concept and to ensure that the prudential treatment of such securitisation investments of EU insurers and reinsurers is in line with that applicable to securitisation exposures of EU credit institutions and investment firms under the CRR.

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[3] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the procedures to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

[4] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities

[5] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010

[6] Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance

Legislative Process

At this stage, the Proposed Regulation is a draft proposed by the Commission. It will be considered by the Council of Ministers, which comprises representatives of the Member States' governments, and by the European Parliament, which is directly elected by voters in the Member States. Both the Council of Ministers and the European Parliament may amend the text proposed by the Commission. Once an identical text is approved by the European Parliament and Council (which is expected to be during the course of the second or third quarter of 2016), the Proposed Regulation will be published in the Official Journal of the European Union and will enter into force on the date that is 20 days following such publication (the "**Effective Date**").

As the Proposed Regulation is in the form of a regulation rather than a directive it will be directly applicable law across the EU without the need for any legislation or administrative actions in the Member States. The intention is to ensure that uniform rules apply in each Member State and across different financial sectors.

Within certain specified periods following the Effective Date, the European Banking Authority (the "**EBA**"), working in conjunction with the European Securities and Markets Authority ("**ESMA**") and the European Insurance and Occupational Pensions Authority ("**EIOPA**"), is required to submit to the Commission draft regulatory technical standards ("**RTS**") elaborating on certain provisions of the Proposed Regulation. The RTS specifying the risk retention requirements in greater detail are required to be submitted to the Commission within six months of the Effective Date. The Commission then has the power to adopt final RTS on the basis of the EBA draft. The scope of the risk retention requirements and certain other aspects of the Proposed Regulation may therefore only become fully apparent following the publication by the EBA of the draft RTS and the adoption by the Commission of the final RTS.

Risk Retention

The rationale of the risk retention requirements is that they constitute a mechanism to achieve an alignment of interests of originators and sponsors with investors. The risk retention rules are broadly the same as the rules currently in place with some notable exceptions.

<u>The "Indirect" and "Direct" Approaches</u>

Article 405 of the CRR imposes an obligation on "institutions" (i.e. "credit institutions", mainly being EU regulated banks, and "investment firms") investing in securitisations to ensure that the originator, sponsor or original lender of a securitisation retains an interest in such securitisation.

This is called the "indirect" approach as it places the onus on the institutions to ensure that the originator, sponsor or original lender retains at least 5% of the net economic interest of any securitisation in which it invests.

The Proposed Regulation, however, moves towards a "direct" approach, under which the obligation is placed directly on originators, sponsors and original lenders, rather than on the investors. The Commission hopes that this will increase investor certainty and so encourage new investments in securitisations.

The Proposed Regulation does not include any jurisdictional scope on the application of this direct obligation other than a statement in the recitals which provides that in circumstances where there is no originator, sponsor or original lender in the EU, the "indirect" approach will continue to apply. This would indicate that the intention of the Commission is to limit the "direct" approach to EU originators, sponsors or original lenders only, but there is not a specific reference to its jurisdictional scope in the body of the Proposed Regulation.

There remain a number of drafting issues with the "direct" obligation requirement. As currently drafted, any originator, sponsor or original lender is required to comply with the Proposed Regulation. The text goes on to provide that where the originator, sponsor or original lender cannot agree who should retain, the originator shall be required to retain. This is very problematic, particularly in transactions where there is more than one originator (i.e., where the securitisation has purchased assets from multiple parties). Despite the efforts of market participants, the Commission has not clarified that the direct obligation applies to originators, sponsors and original lenders who are directly involved in the applicable securitisation. We hope that this can be clarified prior to the Proposed Regulation coming into force.

Retention Financing

Article 12 of the current RTS permits retention holders to use their retention positions as collateral for secured financings provided that the credit risk of the retention is not passed on to the finance provider. In the event that the retention holder defaults on a financing arrangement, the finance provider would expect to be able to enforce any security granted to it and to be able to liquidate all secured assets. Under the current regime, the retention holder would no longer be retaining. However, at least in the context of an institution regulated by the CRR, provided investors performed their due diligence, the expectation would be that the applicable national regulator would not impose a punitive capital charge as a consequence of such non-compliance. Under the Proposed Regulation, upon a liquidation of the retention, the originator, sponsor or original lender retention holder would be in breach of the Proposed Regulation for failing to retain. We hope that the position on retention financing is clarified in the new RTS to provide that an enforcement action by a lender would not cause the retention holder to be in breach of its obligations under the Proposed Regulation.

Definitions of Originator and Sponsor

Definition of "Originator"

The Proposed Regulation defines "originator" in the same manner as in the CRR as either (i) an entity that itself or through related entities, directly or indirectly, was involved in the original

agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised, or (ii) an entity that purchases a third party's exposures for its own account and then securitises them.

In its report on securitisation retention, due diligence and disclosure requirements dated 22 December 2014, the EBA identified what it considered to be a potential loophole that could result from the abuse of the "originator" definition in the CRR. The EBA noted the possibility of creating an "originator" that met the legal definition of the CRR and which would hold the retention in a securitisation, but that could be established solely for buying exposures and securitising a third party's exposures. The EBA gave its opinion that the definition should ensure that the "originator" should be an entity of real substance.

Earlier working drafts of the Proposed Regulation addressed this concern by restricting the definition of "originator" to an entity established or operating "primarily" for the purpose of securitising exposures. There were, however, concerns that this provision was too broad in that it would prohibit entities that use the securitisation markets as their primary funding source from acting as retention holders.

This wording broadly follows wording proposed to the Commission by Cadwalader and four other law firms. In particular, proposed Article 4(1) provides:

"*For the purposes of this Article, 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*."

It is also stated in the explanatory memorandum to the Proposed Regulation:

"*This proposal also takes into account the EBA recommendation to close a potential loophole in the implementation of the risk retention regime whereby the requirements could be circumvented by an extensive interpretation of the originator definition. To this aim, it is specified that for the purposes of Article 4 an entity established as a dedicated shelf for the sole purpose of securitising exposures and without a broad business purpose cannot be considered as an originator. For instance, the entity retaining the economic interest has to have the capacity to meet a payment obligation from resources not related to the exposures being securitised.*"

The "sole purpose" test is in our view a clearer test and should provide the market with additional comfort on the use of originator retention structures while addressing the concerns raised by the EBA.

Definition of "Sponsor"

The definition of "sponsor" is the same as that in the CRR; it is a credit institution, or investment firm (as defined in the CRR), other than an originator that establishes and manages an asset-backed commercial paper ("**ABCP**") programme or other securitisation transaction or scheme

that purchases exposures from third-party entities. Despite concerns that the use of the CRR definition of “investment firm” is overly narrow in that it unnecessarily excludes certain regulated EU firms, as well as non-EU firms (such as US Investment Advisers) that are entities suitable to hold the retention and which would ensure the correct alignment of interests with investors, the sponsor definition has not been widened in the Proposed Regulation from that in the CRR.

Transitional Arrangements

A major concern raised in relation to earlier drafts of the Proposed Regulation was the absence of grandfathering provisions in relation to the applicable retention requirements for securitisations which are compliant with the current regime. Under the current provisions in the CRR, investors in securitisations need to ensure compliance with the retention rules; there is not a direct obligation on an originator, sponsor or original lender to retain. As discussed above, the Proposed Regulation will impart a direct legal obligation on an originator, sponsor or original lender to retain. An earlier working draft of the Proposed Regulation applied this new obligation retrospectively to all securitisations issued on or after 1 January 2011 and to securitisations issued before that date, where new underlying exposures have been added or substituted after 31 December 2014. After representations to the Commission, the transitional arrangements no longer contain this provision.

The transitional arrangements in the Proposed Regulation state that, subject to specified exceptions, the Proposed Regulation shall apply to securitisations, the securities of which are issued on or after the Effective Date.

The position as regards risk retention is that until the new RTS on risk retention are adopted by the Commission, the risk retention provisions included in the current RTS (Commission Delegated Regulation (EU) No 625/2014) will apply to securitisations the securities of which have been issued prior to the Effective Date. For securitisations which are issued on or after the Effective Date such transaction may rely on the current RTS until the new RTS come into force. This provides some assurance as to the risk retention requirements applicable to existing securitisations and to those securitisations taking place before the adoption of the new RTS. However, any securitisation issued after the Effective Date will eventually need to comply with the new RTS retrospectively.

Due Diligence

Proposed Requirements

The Proposed Regulation sets out due diligence requirements that apply to EU institutional investors assuming exposure to securitisation exposures. The requirements encompass actions to be undertaken prior to assuming exposure to a securitisation and actions to be undertaken on an on-going basis thereafter. The requirements are based on those that currently apply to EU credit institutions, investment firms, insurers, reinsurers and managers of alternative investment funds that are within the AIFMD. With effect from the Effective Date, those types of

institutional entities will become subject to the due diligence requirements in the Proposed Regulation in place of the sectoral rules that currently apply. Internally managed UCITS, UCITS management companies and occupational pension schemes will also become subject to due diligence requirements for the first time. The due diligence requirements under the Proposed Regulation apply where exposure is assumed to a securitisation, which covers not only investing in the securitisation as a lender or noteholder but also other cases where there is an exposure, e.g. as counterparty under a swap.

Having a common set of due diligence requirements across all types of institutional entities is an improvement on the current position of three different sets of requirements with material differences between them. Also helpful is the omission from the due diligence requirements in the Proposed Regulation of a number of requirements under the existing sectoral rules, including: (i) to analyse and record methodologies and concepts used in valuation of the collateral for the underlying exposures, the policies adopted to ensure independence of the valuer, and the statements made by the originators or sponsors regarding their due diligence on the underlying exposures and (ii) to ensure that the originator, sponsor or original lender has a written policy on credit risk that includes their risk tolerance limits and provision policy and how it measures, monitors and controls that risk, and has effective systems to manage the on-going administration and monitoring of their credit risk-bearing portfolios and exposures. The Proposed Regulation also omits the requirements under the existing sectoral rules to look behind the commitment of the entity committing to retain and consider factors that could undermine the maintenance of the required retention and to analyse and record the reputation and loss experience in previous securitisations of the relevant originator and sponsor. The qualitative due diligence requirements in the Proposed Regulation expressly state that the various aspects of initial and on-going due diligence is to be commensurate to the securitisation position, including, variously, its risk profile and complexity, language which is not the case in all of the existing sectoral rules.

The due diligence requirements in the Proposed Regulation have implications for those involved in U.S. and other non-EU securitisations which have as investors EU institutional entities subject to such requirements. Such investors may assume exposures only to securitisations that satisfy the risk retention and disclosure requirements in the Proposed Regulation. In the case of securitisations which involve EU entities as originators, sponsors or original lenders, such entities will in any case be subject to the obligation under the Proposed Regulation to satisfy the retention requirement and provide the requisite disclosure. In the case of originators, sponsors or original lenders that are not EU entities, there is no obligation on them to satisfy the retention requirement or to provide the requisite disclosure, but one such entity will need to do so if EU institutional entities subject to the due diligence requirement are to invest in the securitisation. In the case of the retention requirement, this “indirect” approach does not represent a change to the current position. However, the Proposed Regulation represents the first EU securitisation legislation that requires investors to ensure that originators, sponsor and issuers are fulfilling their requirements under securitisation disclosure rules and thereby gives rise to a need for U.S. and other non-EU securitisations to comply with such disclosure rules in order to have EU institutional entities as investors.

One of the most problematic aspects of the Proposed Regulation is that an EU institutional investor that assumes exposure to a securitisation designated as STS securitisation is obliged to carry out a due diligence assessment of whether the securitisation in fact satisfies the STS securitisation requirements. The Proposed Regulation states that such EU institutional investor may place appropriate reliance on the fact that notification has been made to ESMA that a securitisation complies with the STS securitisation requirements and on the disclosure by the originator, sponsor and issuer regarding such compliance. However, the Proposed Regulation does not indicate what constitutes appropriate reliance as distinct from inappropriate reliance. The requirement for each EU institutional investor to separately assess, in the case of a securitisation, whether the STS securitisation requirements are satisfied imposes a cost burden on EU institutional investors that seek to benefit from the more favourable capital treatment applicable to exposures to STS securitisations. Furthermore, an EU institutional investor that makes its own assessment of whether the STS securitisation requirements are satisfied is subject to the risk of significant administrative sanctions and remedial measures under the Proposed Regulation in the case that such assessment is incorrect, which is likely to deter it from relying upon a securitisation being an STS securitisation. These issues may reduce the likelihood of EU institutional investors relying in practice upon the lower capital requirements that apply to STS securitisation exposures with the result that the usefulness of STS securitisation as a concept is negated.

Instead of EU institutional investors bearing the full burden of determining whether a securitisation satisfies the STS securitisation requirements, ESMA, national regulators in EU member states, or third parties designated and supervised by ESMA, could assess whether a securitisation satisfies the STS securitisation requirements with an EU institutional investor able to rely on the outcome of such assessment in the absence of some level of knowledge or notice on the part of such investor that the STS securitisation requirements were not satisfied. For the past decade national regulators in EU member states have been responsible for assessing prospectuses to confirm that they comply with the disclosure standards under the EU Prospectus Directive[7]. Having national regulators assess securitisations to confirm that they satisfy the STS securitisation requirements is a task of similar nature. Indeed, in both cases what is involved is principally a review of disclosure. Alternatively, the Prime Collateralised Securities initiative that has been operating for several years represents an example of how an arrangement involving assessment by designated and supervised third parties could work.

Transitional Arrangements

The transitional arrangements under the Proposed Regulation state that the due diligence requirements apply to securitisations which were issued on or after 1 January 2011 and to securitisations issued before that date, where new underlying exposures have been added or substituted after 31 December 2014. From the Effective Date, EU regulated investors will need to satisfy the due diligence requirements in respect of securitisations that may have been

[7] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the procedures to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC

issued prior to such date, including the requirements to verify that the retention requirements and disclosure requirements under the Proposed Regulation are satisfied. However, the transitional arrangements also state that the retention requirements and the disclosure requirements apply only to securitisations issued after the Effective Date. There is thus an obvious conflict within the transitional arrangements themselves. The only sensible way to interpret the transitional arrangements is that for those securitisations issued prior to the Effective Date, due diligence must be undertaken not in respect of the retention requirements under the Proposed Regulation but in respect of the risk retention requirements that apply under the existing sectoral rules. Such an interpretation is supported by the express statement in the transitional arrangements that such retention requirements under the existing sectoral rules are to continue to apply to those securitisations issued prior to the Effective Date.

Disclosure

The Proposed Regulation sets out disclosure requirements that are to be satisfied by securitisation originators, sponsors and issuers. These disclosure requirements represent a third EU disclosure regime for securitisations. In 2013 the European Central Bank ("**ECB**") established an optional regime for loan-level data reporting by securitisations. Compliance with such regime is a condition for the senior class of notes of a securitisation to be eligible collateral for borrowing from the ECB or to be purchased by the ECB under its asset-backed securities purchase programme. Also in 2013 Article 8b of Regulation (EC) 1060/2009 on Credit Rating Agencies provided that issuers, originators and sponsors of securitisation are to publish on a website established by ESMA information on the credit quality and performance of the underlying assets of the securitisation, its structure, cash flows and any collateral, as well as information necessary to conduct comprehensive and well-informed stress tests. RTS setting out detailed requirements for such disclosure are contained in Commission Delegated Regulation (EU) 2015/3 of 30 September 2014 supplementing Regulation (EC) No 1060/2009 of the European Parliament and of the Council with regard to the RTS on disclosure requirements for structured financial instruments ("**Regulation 2015/3**"), which came into force on 26 January 2015.

The disclosure regime in the Proposed Regulation is very similar to the Regulation 2015/3 disclosure regime. Both regimes require disclosure of the final prospectus or offering circular, transaction documents, quarterly asset-level data reporting, quarterly investor reporting and ad hoc reporting of inside information required under Article 17 of Regulation (EU) No 596/2014 on Market Abuse (or, if that is not applicable, ad hoc reporting on a similar basis). The Proposed Regulation also requires, in the case of STS securitisations, disclosure of any notification made to ESMA that the securitisation meets the requirements to be a STS securitisation and also where the securitisation ceases to meet the STS securitisation requirements and where competent authorities have taken remedial or administrative actions.

It seems highly undesirable that originators, sponsors and issuers would have to comply with two separate disclosure regimes which are very similar but have a number of differences. However, the Proposed Regulation does not repeal Article 8b nor purport to replace Regulation

2015/3 and wording in the Commission proposal suggests that the disclosure regime in the Proposed Regulation is intended to apply alongside the ECB loan-level data reporting regime and the Regulation 2015/3 disclosure regime. There can be no justification for originators, sponsors and issuers having to do asset-level data reporting on three different templates - those adopted by the ECB for the purpose of its loan-level data reporting, those under Regulation 2015/3, and those contained in RTS adopted under the Proposed Regulation. It is to be hoped that this issue can be addressed in the Proposed Regulation prior to it being adopted and becoming effective.

Differences between the disclosure regime in the Proposed Regulation and the Regulation 2015/3 disclosure regime include:

- Disclosure under Regulation 2015/3 will apply from 1 January 2017 in respect of securitisations issued on or after 27 January 2015. Disclosure under the Proposed Regulation will apply from the Effective Date in respect of securitisations issued on or after that date.

- Under Regulation 2015/3 a third party reporting entity may be designated, but that is without prejudice to the responsibility of the originator, sponsor and issuer. Under the Proposed Regulation there is no provision for a third party reporting agent to be designated but there is provision for the originator, sponsor and issuer to designate amongst themselves one entity to be responsible for making the disclosure. The STS securitisation requirements in the Proposed Regulation include a requirement that the originator, sponsor and issuer be jointly responsible for compliance with the disclosure regime in the Proposed Regulation, implying that in the case of securitisations not satisfying the STS securitisation requirements only the entity designated to undertake the disclosure is responsible.

- Under Regulation 2015/3 the disclosure is required to made on a website established by ESMA which is publicly accessible. Under the Proposed Regulation the disclosure is required to be made to investors and competent authorities via a website that satisfies certain criteria but such website does not need to be the ESMA website and public disclosure is not required.

- Under Regulation 2015/3 private and bilateral transactions are not currently subject to the asset-level data reporting requirements. The Proposed Regulation has no equivalent provision. The exclusion of private and bilateral transactions under Regulation 2015/3 is a temporary measure while ESMA consults on how private and bilateral transactions should be defined and what asset-level disclosure requirements should apply to such transactions. The main concern raised with ESMA regarding private and bilateral transactions is the public nature of the disclosure required to be made under Regulation 2015/3. As the Proposed Regulation does not require public disclosure of the information disclosed, the Commission may have considered that it is unnecessary to make an exception for private and bilateral transactions.

- Under Regulation 2015/3 periodic asset-level data reporting and investor reporting is required on a quarterly basis with no special treatment for ABCP. Under the Proposed Regulation periodic asset-level data reporting and investor reporting for ABCP is required to be made on a monthly basis.

- Minor differences between the items of information required to be included in investor reporting under Regulation 2015/3 and the items of information required to be included in investor reporting under the Proposed Regulation. In particular, the investor reporting under the Proposed Regulation requires the inclusion of information about the retention.

Regulation 2015/3 sets out asset-level data reporting templates for seven different asset classes: residential mortgages, commercial mortgages, SME loans, auto loans, consumer loans, credit card loans, and leases. The Proposed Regulation does not include any such reporting templates but provides that RTS are to be prepared by ESMA and adopted by the Commission setting out such templates, including the information to be reported. The transitional provisions in the Proposed Regulation provide that until such RTS are adopted, originators, sponsor and issuers shall post to the website established for such purpose the information using the asset-level data reporting templates contained in Regulation 2015/3. Oddly, the transitional provisions also provide that until such RTS are adopted, originators, sponsor and issuers shall make the investor reporting provided for under Regulation 2015/3 even though there is separate investor reporting already detailed in the Proposed Regulation and the RTS to be adopted under the Proposed Regulation relate only to the asset-level data reporting and the STS securitisation notification and not to investor reporting. The transitional provisions in the Proposed Regulation are unclear as to whether any asset-level data reporting under the Proposed Regulation is required in the case of asset classes for which Regulation 2015/3 does not contain asset-level data reporting templates.

As noted above, the due diligence requirements under the Proposed Regulation have the effect that EU institutional investors subject to them can only invest in a U.S. or other non-EU securitisation if the originator, sponsor and issuer of such a securitisation complies with the disclosure requirements in the Proposed Regulation. This is perhaps a reason why the disclosure requirements under the Proposed Regulation do not require reporting via a website established by ESMA but allow for reporting to be done via any website that satisfies the conditions. It is to be hoped that the RTS adopted for the purpose of asset-level data reporting under the Proposed Regulation are drafted in such a way that it will be possible for U.S. securitisations to use the same asset-level data reporting to satisfy such RTS as are used to satisfy the asset-level data reporting requirements that will apply under Regulation AB II to securitisations offered on or after 23 November 2016.

STS Securitisation

In October 2014, the EBA published a discussion paper on simple, standard and transparent securitisations in response to a call for advice from the Commission with respect to the merits of, and potential ways of, promoting a safe and stable securitisation market, which included proposed criteria for STS securitisations. Following a public consultation process, the EBA published a report on qualifying securitisation in July 2015 which refined the criteria further and also added criteria for ABCP securitisations and ABCP programmes. In parallel, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions have been developing criteria for identifying simple, transparent and comparable

securitisations, which were published in July 2015. One key objective of the development of such criteria has been to obtain better regulatory capital treatment for securitisations that meet the requirements.

The criteria for STS securitisations in the Proposed Regulation are based on the criteria developed by the EBA, and include criteria for securitisations, ABCP transactions and ABCP programmes. While there have been some changes that are likely to be welcomed by many market participants, it remains to be seen whether these criteria are sufficiently flexible to allow them to be adopted for a significant number of transactions.

Particular types of transactions are likely to be excluded at present, for example the criteria do not allow for active portfolio management so would prevent managed CLOs from being STS securitisations. Historical data is required for a period of at least seven years for non-retail exposures and five years for retail exposures, thus excluding businesses which have been originating the relevant assets for a shorter period of time. In addition, the underlying exposures are required to be homogeneous in terms of asset type, but it is not clear what this means. The criteria apply only to "true sale" transactions, although the Commission intends to consider whether synthetic securitisations can be included in the future.

Various provisions would benefit from further clarification. For example, both the originator and the servicer are required to have expertise (in originating similar exposures or in servicing the exposures, respectively), but it is not clear how this is to be assessed.

Another concern is that certain information required to be disclosed will be required to be provided, at least in draft or initial form, before pricing of the transaction. This is likely to present significant challenges in terms of timing of transactions, and raises questions in relation to what would happen if the relevant documents are amended.

The originator, the sponsor and the issuer will be jointly responsible for notifying ESMA that a securitisation meets the requirements for an STS securitisation, and ESMA will then publish that notification on its website. RTS will be required to be developed in order to specify the information which must be provided to ESMA. While investors will still be required to carry out due diligence, they will be able to rely on the STS securitisation notification. The originator, the sponsor and the issuer may agree that one of them should be the designated contact point for investors and competent authorities.

Sanctions and Remedial Measures

Extensive administrative sanctions and remedial measures are envisaged for failure to comply the risk retention, disclosure and STS securitisation provisions, including substantial fines.

Further Reviews

The Proposed Regulation provides for the monitoring and evaluation of its impact. The Proposed Regulation mandates the EBA to report on the implementation of the STS securitisation requirements and the impact of the new measures two years after the Effective Date, with further reports every three years thereafter. ESMA is also required to report on the functioning of the transparency requirements three years after the Effective Date. Finally, four years after the Effective Date, the Commission will report on the functioning of the Proposed Regulation.

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