Clients&FriendsMemo

Final Proposal For Revisions To The EU Securitisation Regulation And The Capital Requirements Regulation

19 June 2025

The EU has now published its final proposal here (the "**SecReg Proposal**") for a regulation amending Regulation (EU) 2017/2402 ("**SecReg**"). This memo discusses the most notable changes from the 2017 version of SecReg, many of which reflect the 2025 report by the Joint Committee of the European Supervisory Authorities (for our note on that see here). However, key provisions relating to risk retention, the ban on re-securitisations and credit granting standards will remain unchanged under the SecReg Proposal.

To accompany the SecReg Proposal, a number of concomitant changes have been proposed to the Capital Requirements Regulation (the "**CRR Proposal**"). Notable changes are discussed below. The link to the CRR Proposal is here.

These proposals aim to "*recognise the risk mitigants implemented in the EU securitisation, regulatory and supervisory frameworks, which have significantly reduced the risks embedded in in securitisation transactions, as well as the good credit performance of EU securitisations*". This is in order to amend non-prudential and prudential requirements to encourage more engagement in securitisations by the removal of "*undue issuance and investment barriers in the EU securitisation market*".

As of today, the SecReg Proposal and the CRR Proposal remain proposals; they must still go through the trialogue process of a proposal by the Commission, and then a review by the Parliament and Council of the EU. Changes may be tabled and the process can involve amendments. Once the Parliament and Council agree joint texts, the legislation will be adopted, though this can be a lengthy process. Following adoption, we can expect draft Regulatory Technical Standards ("**RTS**") to be published for consultation.

Those RTS will deal with operational implementation of the proposals, presumably including details of the contents of revised reporting templates.

In addition to the SecReg Proposal and the CRR Proposal, draft amendments to the Liquidity Coverage Ratio Delegated Regulation have also been published on a "Have Your Say" basis for

a four-week consultation. The Commission also plans to publish its proposed amendments to the Solvency II Delegated Regulation in the second half of July.

SECREG PROPOSALS

Scope

Article 1(1) of the SecReg Proposal amends the scope of SecReg so as to apply to "*institutional investors and to originators, sponsors, original lenders, servicers* [emphasis added] *and securitisation special purpose entities.*" The previous draft of the SecReg Proposal's explanatory note asserts that the addition of "servicers" is simply a clarification and that SecReg already applies to servicers managing a pool of purchased receivables or the underlying credit exposures on a day-to-day basis. This, however, is not repeated in the final proposal.

Definitions of public and private securitisations

Article 1(2) of the SecReg Proposal amends the definition of a "public securitisation" to mean a securitisation that meets any of the following criteria:

- a prospectus is required[1];
- the notes are admitted to trading on a Union trading venue[2]; or
- marketing to investors takes place on a non-negotiable basis.

Though the quantum of "negotiation" is undefined, Recital (3) of the SecReg Proposal describes the absence of negotiation as the scenario when marketing "*to investors under non-changeable terms and conditions where the package is offered on a "take-it-or-leave-it" basis and investors have no direct contact with the originator or sponsor and can therefore not directly receive necessary information to conduct due diligence without the originator or sponsor disclosing any commercially sensitive information to the market.*"

In contrast, the new definition of "private securitisation" is one that does not meet any of the criteria applicable to public securitisations (see Article 1(2) of the SecReg Proposal).

The result of this change, should it be adopted, is that many more securitisations will be classified as "public securitisations". In our view, the ability for certain "anchor" investors to review and comment on an advanced draft or "preliminary" offering memorandum may not, in and of itself,

[1] Pursuant to Article 3 of Regulation (EU) 2017/1129.

[2] As defined in Directive 2014/65/EU.

cause the transaction to be considered "negotiated" (and therefore private) for the purposes of the above.

The classification of whether a transaction is public or private will determine the type of transparency template reporting a transaction must use and whether such template reporting is available to investors and potential investors via a securitisation repository. *See Transparency below*.

Due diligence

The aim here is to streamline and simplify due diligence requirements by:

- removing verification requirements for risk retention in Article 5(1)(c) of SecReg for investors when the sell-side is established and supervised in the EU;
- making the risk assessment required currently by Article 5(3)(b) of SecReg principles-based and proportionate to the risk involved by removing the list of features that investors are required to verify. The principles are described (but not enumerated) in new Recital 4 as requiring investors to focus on risk characteristics and structural features that can materially affect performance and avoiding duplicative and overly burdensome or generic obligations. However, despite the above "principles based" approach, the rules for verifying investments in third county issuances set out in SecReg will continue to apply to investors in their current form (see below);
- providing that secondary market transactions will have an extra 15 days to document their due diligence;
- deleting Article 5(3) of SecReg, which required verification of compliance with certain Articles of SecReg in respect of STS transactions;
- deleting Article 5(4)(a) which required the establishment of written procedures to cover monitoring of exposures;
- disapplying due diligence requirements when securitisation positions are guaranteed by a multilateral development bank[3]; and
- providing for lighter due diligence in cases when the securitisation includes a first loss tranche that is guaranteed or held by a defined list of public entities and when that tranche represents at least 15% of the nominal value of the securitised exposures.

[3] As listed in Article 117(2) of Regulation (EU) 575/2013, with the guarantee subject to the conditions of Article 213 and 215 of Regulation (EU) No. 575/2013.

However, the SecReg Proposal's revised Article 5 does nothing to relieve the due diligence burden for third country securitisations including the requirement for EU institutional investors to confirm compliance with Article 6 (*Risk Retention*) and Article 7 (*Transparency*). In our view, the SecReg Proposal does not go nearly far enough to relieve the burdensome due diligence requirements imposed on EU institutional investors. The due diligence burden still remains high when compared with other types of investments.

Delegation of due diligence

Article 1(3)(e) of the SecReg Proposal aligns the requirements in respect of delegation in Article 5(5) of SecReg with those set out in AIFMD[4]. While an institutional investor may delegate due diligence obligations to another institutional investor, the delegation will not relieve the delegating investor of the regulatory responsibility for compliance with such obligations.

Risk retention

Risk retention is now waived when the securitisation includes a first loss tranche that is guaranteed or held by a narrowly defined list of public entities and when that tranche represents at least 15% of the nominal value of the securitised exposures.

Transparency

- The headline change here is the stated aim of reducing the number of mandatory reporting fields by at least 35%, and that consideration should be given to distinguishing between mandatory and voluntary fields. This work is tasked to the securitisation sub-committee of the ESAs Joint Committee, under the leadership of the EBA in cooperation with the other European Supervisory Authorities.

- Reporting templates for highly-granular and short-term portfolios should no longer require loan level information.

- Article 7(2) of SecReg is amended so as to allow private securitisations a distinct and simplified reporting framework that still contains the essential information relevant to competent authorities. This will be aligned to other well-established templates, in particular the ECB notification of securitisation template.

- The ESAs, through the Joint Committee of the ESAs under the leadership of the EBA, and in cooperation with ESMA and EIOPA, are charged with developing regulatory technical standards to specify disclosure information, taking into account the usefulness of the information for investors and whether the issue is public or private.

[4] Directive 2011/61/EU on Alternative Investment Fund Managers.

- Private securitisations are now required to report to securitisation repositories (in the new modified form), but the SecReg Proposal allows that while those reports need to be accessible to regulatory and other authorities, they will not be accessible by investors or potential investors (an acknowledgment of the confidential nature of many private transactions).

While we welcome the move to reduce the information in respect of public securitisations and the development of a short-form template for private securitisations, the requirement for all securitisations to report to EU securitisation repositories will create an additional burden for securitisation issuers, particularly in the case of third country securitisations. In addition, given the proposed expansion of the definition of "public securitisations", fewer securitisations will be able to use the less burdensome "private securitisation" template.

STS

- Currently, SecReg Article 20(8) requires total homogeneity of the underlying asset class. Article 24(5) requires the same of ABCP. When the asset class is SME loans, this homogeneity is now replaced by a 70% threshold.

- To encourage investment by insurance and reinsurance vehicles in SRT transactions, SecReg Article 26(e) now allows unfunded guarantees provided that: (i) exposures to the investor qualify for a 0% risk weighting; (ii) the undertaking uses an internal risk model; and (iii) the undertaking complies with designated capital requirements.

ABCP

- As noted above, the previous homogeneity requirement for the underlying asset class has been replaced by a 70% threshold when the asset class is SME loans.

- Disclosures for ABCP must now include whether the programme is fully supported by a sponsor.

Sanctions

- Article 32 of SecReg now includes failures by institutional investors to comply with Article 5 due diligence requirements as subject to administrative sanctions.

- Those administrative sanctions can include a pecuniary sanction of up to 10% of the total annual net turnover (on a consolidated basis where applicable).

- Such administrative sanctions could apply as an alternative or potentially in addition to the penalties that already apply under sectoral regimes (for example regulatory capital charges for banks under CRR).

These additional penalties are, in our view, unwarranted and have the potential to disincentivise investment in securitisations by EU institutional investors (both in absolute terms and relative to securitisation investment by non-EU investors).

Sponsor

We note that the SecReg Proposal does not include any clarification of the definition of "sponsor" so as to explicitly permit non-EU investment firms to act as sponsors, in particular for the purposes of holding the risk retention in accordance with Article 6 of SecReg. Accordingly, there remains uncertainty due to the reference to "whether located in the Union or not" in the present definition, as to whether only non-EU credit institutions (as opposed to investment firms) are permitted to act as sponsors. Consistent with the statements made in the 31 March report of the Joint Committee of the European Supervisory Authorities, non-EU investment firms should, in our view, be permitted to act as sponsors and hold the risk retention as such.

CRR PROPOSALS

- A risk-sensitive risk weight floor has been introduced that will be applicable to the determination of risk weights for senior securitisation positions held by banks under all approaches (such formula to reference the effective risk weighting applied to the securitised portfolio, multiplied by a proportionality factor and subject to an overall minimum level).

- This approach should result in a lowering of the risk weight floor for securitisations of low-risk portfolios so as to better reflect the quality of those underlying portfolios and encourage their securitisation.

- At the same time, however, such risk-sensitive approach may increase the risk weight floor for securitisations of leveraged loan portfolios such as CLOs, for example (when underlying asset risk weights may equal or exceed 150%).

- The p-factor applicable to the calculation of risk weights for senior non-STS positions has also been reduced (from 1.0 to 0.6), but only for originators/sponsors; i.e., no relief has been given for banks acting solely as investors in non-STS securitisations.

- A concept of a "resilient" transaction has been introduced, provided certain criteria are met (some of which overlap with the STS criteria, such as the requirement for sequential amortisation of tranches and minimum granularity of the underlying assets).

- Some incremental relief (in terms of risk weight floor and/or p factor reduction) is then provided for resilient transactions (but for senior non-STS positions, only those held by originators/sponsors as opposed to bank investment generally).

Failing to reduce (or potentially even increase in the case of the new risk-sensitive formula for the risk weight floor as mentioned above) capital requirements, particularly for banks investing in

senior non-STS positions including CLOs (as opposed to when acting as the originator/sponsor), will have the effect of increasing the regulatory capital burden and funding costs for banks investing in senior non-STS positions, despite the fact that many of these positions have historically suffered little or no defaults such as CLOs.

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