Clients&FriendsMemo

Securitisation Regulation - Transparency and Article 14 CRR issues: where do we go from here?

3 December 2018

Introduction

On 30 November 2018, the European Banking Authority, the European Securities and Markets Authority ("**ESMA**") and the European Insurance and Occupational Pensions Authority (the "**European Supervisory Authorities**" or "**ESAs**") published a joint statement (the "**Joint Statement**")[1] regarding: (i) the reporting templates to be used for the quarterly[2] underlying exposure and investor reports under Article 7 of the Securitisation Regulation[3]; and (ii) the amendment to Article 14 of the Capital Requirements Regulation ("**CRR**")[4] and its effect on the consolidated application of obligations in the Securitisation Regulation. This memorandum describes the contents of the Joint Statement and considers its likely impact.

The Reporting Templates to be used for Quarterly Reporting under Article 7 of the Securitisation Regulation

Background: the Securitisation Regulation's Transparency Requirements

The Securitisation Regulation will apply to securitisations, the securities of which are issued (or where no securities are issued, the securitisation positions of which are created), on or after 1

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1 https://esas-joint-committee.europa.eu/Publications/Statements/JC_Statement_Securitisation_CRA3_templates_plus_CRR2_final.pdf

2 Monthly for ABCP

3 Regulation (EU) 2017/2402 of the European Parliament and of the Council of 12 December 2017 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation, and amending Directives 2009/65/EC, 2009/138/EC and 2011/61/EU and Regulations (EC) No 1060/2009 and (EU) No 648/2012.

4 Regulation (EU) No 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.

January 2019. We commented on the obligations that will arise under the Securitisation Regulation in our Clients and Friends Memorandum dated 26 October 2017[5].

The Securitisation Regulation provides that the originator, sponsor and Securitisation Special Purpose Entity ("**SSPE**") (i.e. the issuer) of a securitisation must make certain prescribed information relating to the securitisation available to investors, competent authorities (i.e. national regulators) and, upon request, to potential investors[6]. The originator, sponsor and SSPE are to designate one of them to fulfil the disclosure requirements (the "**reporting entity**").

Background: ESMA's draft Disclosure Technical Standards

One of the requirements of Article 7 of the Securitisation Regulation is the provision of quarterly[7] underlying exposure and investor reporting to be made using standardised templates. Article 7 directed ESMA to develop draft technical standards specifying the form and content of these reporting templates (the "**Disclosure Technical Standards**"). In August 2018, ESMA published its Final Report (the "**Final Report**")[8] which annexed final draft technical standards including the detailed draft reporting templates. ESMA's Final Report was discussed in our Clients and Friends Memorandum dated 28 August 2018[9]. The Disclosure Technical Standards need to be adopted by the European Commission in the form of a delegated regulation in order to become effective.

In its Final Report, ESMA noted that respondents to its consultation had emphasised the need for sufficient time to adapt to the proposed reporting requirements. Although ESMA emphasised that legally this is a matter for the Commission, it proposed a transition period for the implementation of the technical standards so that they could apply in a gradually increasing manner over 15-18 months.

The Joint Statement and the Current Status of the Reporting Templates

In the Joint Statement, the ESAs noted that the reporting templates being prepared by ESMA for the purposes of fulfilling the on-going disclosure requirements under the Securitisation Regulation (the "**ESMA Disclosure Templates"**) are unlikely to be adopted by 1 January 2019,

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5 https://www.cadwalader.com/resources/clients-friends-memos/european-parliament-votes-to-adopt-the-securitisation-and-crr-amendment-regulations

6 For "public securitisations" i.e. those where a Prospectus Directive compliant prospectus has to be drawn up – which is the case where securities are admitted to trading on an EU regulated market, the information has to be made available by means of a securitisation repository registered with ESMA.

7 Monthly for ABCP

8 https://www.esma.europa.eu/press-news/esma-news/esma-defines-disclosure-standards-under-securitisation-regulation

9 https://www.cadwalader.com/resources/clients-friends-memos/esmas-final-draft-disclosure-technical-standards

and that, as a result, the Securitisation Regulation transitional provisions will apply for the period following 1 January, until the application of the ESMA Disclosure Templates.

The Commission is still considering the ESMA Disclosure Templates in the light of the considerable market concern that has been raised regarding their contents. The Joint Statement said that ESMA and the Commission are *"currently considering how to address market concerns raised about some aspects of the ESMA Disclosure Templates"*. We are expecting an announcement shortly from the Commission on their approach to the ESMA Disclosure Templates. It appears that the Commission may well suggest revisions to the templates and that they may also address ESMA's proposal for an implementation period.

The use of CRA3 Templates until the Securitisation Regulation Templates Apply

According to Article 43(8) of the Securitisation Regulation:

"Until the regulatory technical standards to be adopted by the Commission pursuant to Article 7(3) of this Regulation apply, originators, sponsors and SSPEs shall, for the purposes of the [underlying exposures reports and investor reports] make the information referred to in Annexes I to VIII of Delegated Regulation (EU) 2015/3 available in accordance with Article 7(2) of this Regulation."

Annexes I to VIII in Delegated Regulation (EU) 2015/3 (the **"CRA3 Delegated Regulation"**)[10] contain templates for reporting structured finance instruments backed by the following underlying asset classes: residential mortgages; commercial mortgages; loans to small and medium-sized enterprises; auto-loans; consumer loans; credit card-loans; and leases to individuals and/or businesses, and details of the associated investor reports. These Annexes (the "**CRA3 Templates**") do not include a template for CLO reporting.

The legal position is therefore that in the period from 1 January 2019 until the application date of the Disclosure Technical Standards and the associated ESMA Disclosure Templates, these CRA3 Templates will apply.

The Problems Identified by the ESAs

The Joint Statement said that the ESAs have been made aware of *"severe operational challenges"* for reporting entities in their having to report, on a transitional basis, using the CRA3 Templates, in particular regarding those reporting entities that have never provided the information required under the CRA3 Templates. The ESAs further noted that reporting entities may have to make

[10] 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 regulatory technical standards on disclosure requirements for structured finance instruments.

substantial and costly adjustments to their reporting systems in order to comply with the CRA3 Templates.

The Limits to the ESAs' Powers

The ESAs said in the Joint Statement that neither they, nor the competent authorities, have any formal legal power to allow the disapplication of directly applicable EU law (for example, by issuing U.S. style no-action letters). They are therefore limited in the extent as to what they can propose to address the problems identified.

The ESAs' Suggested Approach

In view of these operational difficulties and market concerns, the ESAs have noted that they expect competent authorities generally to apply *"their supervisory powers in their day-to-day supervision and enforcement of applicable legislation in a proportionate and risk-based manner"*. This approach means that competent authorities can, when examining reporting entities' compliance with the Securitisation Regulation's disclosure requirements, *"take into account the type and extent of information already being disclosed by reporting entities"*. The ESAs stress that this does not constitute *"general forbearance"*, but entails a *"case-by-case assessment"* by competent authorities of the degree of compliance with the Securitisation Regulation's transparency obligations. In this context, it should be emphasised that the Joint Statement is not a legally binding document.

The ESAs also stated that they expect that these difficulties will be resolved once the Disclosure Technical Standards and the associated ESMA Disclosure Templates have been adopted (and once they apply), at which stage the transitional arrangements relating to the CRA3 Templates will no longer apply.

Other Elements of Article 7 Reporting

It is important to note that the Joint Statement concerns the templates to be used for ongoing underlying exposure reports and investor reports, and that it does not override any of the obligations on the reporting entity under Article 7 of the Securitisation Regulation.

It should also be stressed that reporting using the templates is only one of the requirements of Article 7. For example, the obligations under Article 7 to provide copies of transaction documentation before pricing will apply, whatever the status of the templates. Furthermore, there are ongoing obligations under Article 7 to report any "inside information" relating to the securitisation and information on "significant events" that will apply.

What does the Joint Statement mean for Asset Classes that have a CRA3 Template?

The apparent purpose of the Joint Statement is to give scope to the competent authorities to allow a margin of appreciation regarding how securitisations subject to the Securitisation Regulation provide underlying exposure and investor reporting during the period up to the date of application of the Disclosure Technical Standards. Given that the ESAs do not, as they say, have legal authority to disapply legal requirements, the safest option for securitisations involving asset classes for which there is a CRA3 Template, would be to provide reporting using the applicable CRA3 Template.

For some asset classes, for example, EU CMBS, reporting using the relevant CRA3 Template is already market standard. However, the Joint Statement suggests that competent authorities may accept reporting on a securitisation being in a form other than the CRA3 Template for the relevant asset class, provided that the substance of the reporting covers those items which are provided for in the applicable CRA3 Template. This flexibility may be helpful for those asset classes and EU jurisdictions where reporting is not already being done using a CRA3 Template. The Joint Statement expressly states that competent authorities should consider this on a case-by-case basis and so we would advise that those involved in securitisations who propose not to follow the form of a CRA3 Template for the appropriate asset class should note this in advance to their competent authority.

What does the Joint Statement mean for Asset Classes that do not have a CRA3 Template such as CLOs?

Not all asset classes have a CRA3 Template for underlying exposure reporting. For example, there is no separate CRA3 Template for CLOs. However, this does not mean that CLOs do not have to report prior to the ESMA Disclosure Templates applying.

Although the position is by no means yet certain, we expect that EU CLOs issued prior to the application of the ESMA Disclosure Templates will, until required to report using the ESMA Disclosure Templates, provide underlying asset reporting in line with the current CLO market standard monthly and payment date reporting. We note that the scope of such market standard reporting is comparable to that required under the CRA3 Templates for other asset classes. However, it is for the relevant competent authority to determine what they consider sufficient for those asset classes for which no CRA3 Template for underlying exposure reporting exists.

In addition, it should be highlighted that warehouses will also be required to provide reporting. Again, we expect market participants will prepare reports similar to those currently used in CLOs during this transitional period.

We would also point out that, notwithstanding the ESMA Disclosure Templates not yet being applicable, reporting under Article 7 will need to be made available to potential investors as well

as to existing investors. CLOs (and warehouse transactions) will also need to ensure that they report any additional information required by Article 7.

Investor Reports

The CRA3 Delegated Regulation does not contain a template for investor reports, but Annex VIII consists of a list of the contents of investor reports[11]. Investor Reports must be provided quarterly (monthly for ABCP) and need to provide the information prescribed under Article 7 of the Securitisation Regulation. We do not consider that the Joint Statement obviates from the need to provide investor reports pursuant to the Securitisation Regulation, whether or not the underlying asset class is one of those in the CRA3 Templates. In the case of CLOs, it may well be the case that their existing investor reports already cover most, if not all, of the items in the list at Annex VIII to the CRA3 Delegated Regulation.

The Consequences for Transaction Documentation relating to Service Providers

Parties entering into securitisation transactions closing after 1 January 2019 will need to take account of the need to comply with the new ESMA Disclosure Templates once they apply. This is difficult to provide for fully in transaction documentation that will be finalised before the final contents of the ESMA Disclosure Templates are known. Transaction parties are going to need to agree commercial terms for performing Securitisation Regulation reporting under the ESMA Disclosure Templates without knowing the final form of those reporting templates.

It does not seem likely that the obligations in the new templates will be more onerous than those in the draft ESMA Disclosure Templates published in August 2018. The Joint Statement said that market concerns about some aspects of the ESMA Disclosure Templates are currently being considered.

For the purposes of ascertaining the likely extent of the future reporting obligations, it would seem sensible to start from the draft ESMA Disclosure Templates in the August 2018 Final Report. It is to be hoped that the final reporting obligations will, if anything, be less burdensome in certain respects, but the parameters of the expected future reporting obligations to be reflected in contractual documentation could be based on those in the August draft ESMA Disclosure Templates.

[11] Annex VIII investor reports apply where a structured finance instrument is backed by any of the underlying assets referred to Annexes I to VII.

Article 14 CRR issues

The Joint Statement also addressed points arising from the amendment of Article 14 of the CRR. In our Clients and Friends Memoranda dated 26 October 2017, 31 July 2018[12] and 28 August 2018 we outlined an issue that has caused widespread concern regarding the applicability of certain obligations (including the transparency requirements) in the Securitisation Regulation on a consolidated basis as a result of changes to the CRR.

Article 14 of the CRR, as amended by Article 1(11) of the CRR Amendment Regulation[13], applies the obligations in Chapter 2 of the Securitisation Regulation, concerning transparency requirements, risk retention, due diligence, criteria for credit-granting and the ban on re-securitisation, to EU institutions subject to the CRR, on a consolidated basis. As a result of this amendment to Article 14 of the CRR, these requirements – notably, transparency and risk retention - could apply on a consolidated basis to a non-EU subsidiary of an EU bank. Such a subsidiary would have to comply both with the EU transparency and risk retention requirements and with any locally applicable rules. The Joint Statement recognised the difficulties that will arise for such subsidiaries engaging in local securitisation in non-EU countries, particularly with regard to compliance with the EU transparency and risk retention requirements.

It appears that these problems were an unforeseen consequence of the changes to the CRR by the CRR Amendment Regulation. The Joint Statement mentioned that the ESAs expect that these issues will be resolved with the adoption of the new proposals to amend the CRR as part of what is known as "CRR II". The Joint Statement referred to the amendment agreed in trilogue, the effect of which will be that Article 14 of the CRR will only apply the Securitisation Regulation's due diligence requirements (and not its transparency requirements or other obligations) on a consolidated basis. However, it is not clear when these further changes to Article 14 of the CRR will be made.

The Joint Statement gives some reassurance on this point in that it stated that the ESAs (taking the same approach as with the issues surrounding the reporting templates) expect the competent authorities to *"generally apply their risk-based supervisory powers in their day-to-day enforcement of applicable legislation in a proportional manner"*. Again, this approach does not entail a general forbearance principle, but is "*a case-by-case assessment by the CAs of the degree of compliance with the Securitisation Regulation"*. This approach entails competent authorities taking into account the proposed changes to the scope of Article 14 of the CRR, based on the latest trilogue agreement.

Again, the ESAs do not have the power to disapply Level 1 legislation, but they have indicated clearly to competent authorities a pragmatic way in which they can deal with the enforcement of

[12] https://www.cadwalader.com/resources/clients-friends-memos/ebas-draft-eu-risk-retention-regulatory-technical-standards

[13] Regulation (EU) 2017/2401 of the European Parliament and of the Council of 12 December 2017 amending Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms

the provisions in Article 14 of the CRR insofar as they affect non-EU subsidiaries of CRR institutions. We would encourage affected clients to consult with their competent authorities so as to confirm their approach to enforcement as regards Article 14.

Conclusion

The Joint Statement recognises two of the most significant problems arising from the new Securitisation Regulation regime. The contents of the Joint Statement are encouraging in recording the ESAs' expectation that competent authorities will not rigorously enforce these aspects of the regime from 1 January 2019, especially in light of the shortcomings in the legislation applicable from that date. However, the ESAs' Joint Statement does not, and cannot, override the contents of the Securitisation Regulation. It does not disapply certain provisions in the legislation, no matter how unsatisfactory they are.

It does, however, indicate the approach that competent authorities are likely to take when supervising compliance with these aspects of the Securitisation Regulation in its initial application period. We would recommend that market participants engage with their competent authorities as regards compliance with the transparency obligations (and CRR Article 14 obligations where relevant) in the light of the contents of the Joint Statement.

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If you have any questions on these matters, please feel free to contact any of the Cadwalader attorneys below.

Stephen Day	+44 (0) 20 7170 8535	stephen.day@cwt.com
Claire Puddicombe	+44 (0) 20 7170 8533	claire.puddicombe@cwt.com
David Quirolo	+44 (0) 20 7170 8635	david.quirolo@cwt.com
Nick Shiren	+44 (0) 20 7170 8778	nick.shiren@cwt.com
Daniel Tobias	+44 (0) 20 7170 8630	daniel.tobias@cwt.com
Jeremiah Wagner	+44 (0) 20 7170 8542	jeremiah.wagner@cwt.com
Suzanne Bell	+44 (0) 20 7170 8549	suzanne.bell@cwt.com
Robert Cannon	+44 (0) 20 7170 8735	robert.cannon@cwt.com
Assia Damianova	+44 (0) 20 7170 8564	assia.damianova@cwt.com
Neil Macleod	+44 (0) 20 7170 8641	neil.macleod@cwt.com
Sabah Nawaz	+44 (0) 20 7170 8583	sabah.nawaz@cwt.com