

Clients & Friends Memo

HM Treasury Report on its Review of UK Securitisation Regulation (UK Securitisation Risk Retention and Disclosure Requirements)

16 December 2021

Background

On 24 June 2021, the UK Treasury (“**HMT**”) launched a call for evidence on the functioning of the UK Securitisation Regulation (“**UKSR**”). Article 46 of the UKSR required HMT to review the functioning of the legislation in relation to eight specified areas prior to 1 January 2022. In a report published on 13 December 2021 (the “**Report**”), HMT has given its feedback on the responses received in the call for evidence and set out its general intentions in relation to the eight policy areas specified in Article 46. In addition, the call for evidence sought views on the definition of “institutional investor” in the UKSR as it relates to certain non-UK Alternative Investment Fund Managers (“**AIFMs**”), the jurisdictional scope of the UKSR and the capital and liquidity treatment of securitisations.

The Report

Overall Effects of the UKSR

The Report concludes that it is difficult to draw conclusions on the effects of the UKSR (and its predecessor, the EU Securitisation Regulation) on the functioning of the UK securitisation market, as the current regulatory regime has only been in place since January 2019. Furthermore, external factors, like the Covid-19 pandemic, have disrupted financial markets and made it more difficult for HMT to assess the effects of the regime. Key points in the response include:

- HMT remains committed to the full implementation of the UKSR regime, including the incorporation of UK specific risk retention technical standards;
- HMT intends to look at ways to use the securitisation regime to support the “real economy” and the provision of finance to SMEs; and
- HMT is generally satisfied that the UKSR regime guards against risks related to interconnectedness between institutions and financial stability.

Risk Retention

The Report concludes that the risk retention framework under the UKSR works broadly as intended. HMT has not immediately committed to adopting industry suggestions to permit greater flexibility in the modalities for risk retention (e.g., permitting “L-shaped” retention, where a portion of the risk retention would be first loss and a portion to be vertical). That said, HMT and PRA have

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agreed to review specific areas of the risk retention framework in response to industry feedback, including:

- the process for transferring the risk retention from one CLO manager to another where investors choose to replace the manager;
- allowing eligible servicers to fulfil risk retention requirements in Non-Performing Exposures (“**NPE**”) securitisations; and
- calculation of the risk retention on the transaction price for NPE securitisations.

Disclosures for Private Securitisations

HMT considered whether the regime for disclosures applicable to public securitisations (i.e., reporting to a securitisation repository and extra templates) should be extended to private securitisations. A number of market participants had also suggested a more proportionate and flexible regime for certain types of private securitisations. In response, HMT has agreed to consider the categorisation of private and public securitisations, and the degree of flexibility that could be permitted in allowing private securitisations to satisfy UKSR transparency requirements.

STS Equivalence

Article 46 of the UKSR required HMT to consider whether to introduce an equivalence regime for STS securitisations involving non-UK originators, sponsors and SSPEs. Following positive industry feedback, HMT agrees that such an STS equivalence regime should be introduced as part of reforms to the UKSR, and will bring forward proposals for such a regime. In the meantime, however, HMT indicated that it is not minded to remove the requirement for originators and sponsors involved in an STS securitisation to be established in the UK.

Environmental Disclosure Requirements

HMT indicated it had taken into account feedback that there are substantial difficulties in the availability and standardisation of environmental information for disclosure purposes. Accordingly, HMT proposed that any additional environmental disclosure requirements to be added to the UKSR’s transparency templates would be subject to availability of such information. In the longer term, HMT does not expect to set up a standalone green securitisation framework in the immediate future, preferring to wait until further progress has been made in the implementation of the UK’s Sustainability Disclosure Requirements (“SDR”) regime applicable to other financial market participants. The Report does not provide any clear guidance on the potential application of the SDR regime to securitisation transactions.

Third Party Verification Regime

The Report does not propose any changes to the regulatory regime for Third Party Verifiers under the UKSR. HMT also indicated it would continue to monitor whether there is sufficient competition in the TPV market.

The Role of Securitisation Special Purpose Entities (SSPEs)

Article 46 of the UKSR required HMT to assess the possibility of introducing a system of limited licence banks, which would perform the functions of SSPEs and would have the exclusive right to purchase exposures from originators and sell claims backed by the purchased exposures to investors. In line with the industry responses received, the Report concluded that the current

system using SSPEs works well and HMT does not see any rationale for replacing SSPEs with limited licence banks.

Alternative Investment Fund Managers

The Report notes that the UKSR's definition of "institutional investor" as it relates to AIFMs does not specify the jurisdiction in which the AIFM must be authorised or have its registered office. Accordingly, the current definition means that any unauthorised, non-UK AIFMs managing or marketing an AIF in the UK could be considered in scope of the investor due diligence requirements under Article 5 of the UKSR. In the Report, HMT reiterates the view expressed in the initial call for evidence that requiring non-UK AIFMs marketing to investors in the UK to comply with the due diligence requirements creates problems for the FCA in terms of supervision and enforcement, and provides a disincentive for such non-UK AIFMs to market to investors in the UK. HMT therefore plans to amend the definition of "institutional investor" in the future to remove non-UK AIFMs from the scope of the UKSR. HMT rejected industry proposals, however, that would have removed small authorised and small registered UK AIFMs from the UKSR's due diligence obligations.

Jurisdictional Scope of the Transparency Requirements

Article 5(1)(f) of the UKSR requires UK investors to verify that non-UK securitisation manufacturers have made available information which is "substantially the same" as that which they would have received from a UK manufacturer in accordance with Article 7 of the UKSR. HMT received extensive feedback that this wording was unclear and potentially too restrictive, in that it could be read as potentially preventing investment in non-UK or non-EU securitisations (given the lack of similar securitisation transparency regimes in those other jurisdictions). In the Report, HMT rejected the approach suggested by some market participants that the due diligence requirements for non-UK transactions should become principles based, and also an approach considered by the European Supervisory Authorities in relation to the EU Securitisation Regulation requiring the implementation of an equivalence regime for Article 7 disclosures. Instead, HMT has committed to clarify what kind of disclosures are required for securitisations where the manufacturers are established outside the UK.

Capital and Liquidity Treatment

HMT received extensive feedback on the impact of capital and liquidity rules on securitisation market, with some respondents suggesting that insufficiently calibrated rules are a key impediment to the further growth of the UK securitisation market. The Review concludes, however, that HMT does not see a justification for any significant changes to the capital treatment of securitisations, as it consider that such changes would represent a departure from internationally agreed Basel standards. In particular, HMT does not consider that it would be consistent with the Basel standards to permit STS-eligible treatment for CMBS or CLO transactions. Similarly, HMT is not currently minded to expand the UK STS framework to include synthetic securitisations.

Next Steps

HMT has committed to working with the FCA and PRA to bring forward the reforms set out in Report. In particular, the Report notes that HMT is also responsible for a planned overhaul of the UK financial regulatory legislative architecture, in the form of the Future Regulatory Framework Review (the "**FRF Review**"). Under those proposals, while the government would set the scope

and core elements of securitisation regime, responsibility for detailed rule-making and guidance would be delegated to the PRA and the FCA. The Report does not contain, however, any clear timetable for when the proposed changes to the UKSR will be implemented.

Observations

The Report sets out path for greater clarity in the application of UKSR requirements in a number of areas. That said, it is clear that the journey to achieve the aims of the Report may be a long one, subject to the progress of other UK regulatory developments such as the SDR and the FRF Review.

In addition, the Report begins the process of the UKSR diverging from the EU Securitisation Regulation. For example, it is conceivable that the EU may decide to implement an equivalence regime for transparency for non-EU transactions (something that is ruled out in the Report), or implement a formal regime for sustainable securitisations. The EU has also taken a different path in permitting STS eligibility for certain synthetic securitisations. Such divergence may accelerate as legislative changes in the UK and EU take effect, meaning added costs and complexity for market participants.

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

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