Clients&FriendsMemo

European Parliament Rapporteur Publishes Draft Amendments to the Proposed EU Securitisation Regulation

10 June 2016

Introduction

On 6 June 2016, Paul Tang MEP, the Rapporteur of the Committee on Economic and Monetary Affairs ("**ECON**") of the European Parliament, published a "Draft Report", consisting mainly of draft amendments (the "**Proposed Amendments**") to the EU's proposal for a regulation intended to lay down common rules on securitisation and create a European framework for "simple, transparent and standardised" ("**STS**") securitisation (the "**Regulation**").

Some of the key Proposed Amendments include proposals to increase the risk retention requirement to 20% (subject to the ability for this to be lowered in subsequent regulatory technical standards), a requirement that the originator, sponsor or original lender in a securitisation needs to be a regulated entity, a requirement on investors to disclose holdings, a ban on re-securitisation and the establishment of a data repository for the underlying loans in securitisations.

Legislative Background

We discussed the legislative background in our Clients and Friends Memorandum dated 25 May 2016[1], in which we described the working document that had been published by ECON under Paul Tang on 19 May 2016 (the "**Working Document**"). The Proposed Amendments build upon the contents of the Working Document, and follow the first exchange of views on the draft Regulation within ECON on 24 May 2016.

The original proposal for the Regulation was announced on 30 September 2015 by the European Commission (the "**Commission Proposal**"), together with a proposal for amendments to the Capital Requirements Regulation designed to reduce the regulatory capital requirements for exposures to STS securitisations. The European Council's agreed negotiating

[1] http://www.cadwalader.com/resources/clients-friends-memos/update-on-the-eu-sts-and-risk-retention

position on the Regulation was published on 30 November 2015 (discussed in our Clients and Friends Memorandum dated 17 December 2015)[2].

ECON, and the wider European Parliament, are now reviewing the proposed Regulation in detail. Once the Parliament has finalised its proposals, which it is anticipated will take place towards the end of this year, the three EU legislative institutions will negotiate a common position (in "trialogue"). Once this process has been completed, a final version of the Regulation will be published in the Official Journal of the European Union and will enter into force 20 days later.

The Proposed Amendments

The Proposed Amendments have therefore been produced early in the deliberations of the European Parliament, will almost certainly be subject to further changes during the Parliamentary process, and even then, will still need agreement in trialogue. They are therefore a long way from being the final provisions which will appear in the Regulation.

Risk Retention

The main point that has caused concern in the industry is the proposed increase in the risk retention level from 5% to 20%. One of the Proposed Amendments envisages that the originator, sponsor or the original lender of a securitisation will need to retain, on an ongoing basis, a material net economic interest in the securitisation of not less than 20%.

However, the Proposed Amendments do anticipate that a different percentage may be determined in subsequent regulatory technical standards. They provide that the European Banking Authority ("**EBA**"), in cooperation with the European Securities and Market Authority ("**ESMA**") and the European Insurance and Occupational Pensions Authority (known together as the European Supervisory Authorities), will be able propose a lower risk retention rate for the securitisation market as a whole, or for certain segments of that market, by way of draft regulatory technical standards, where they have reason to deviate from the 20% level.

In the Explanatory Memorandum accompanying the Proposed Amendments (the "**Explanatory Memorandum**"), the rationale for this proposed increase is explained as being based on the view that *"risk retention requirements by the issuer should be enhanced to assure a better alignment of interests"* and that *"This will help avoiding moral hazard and make the securitisation market more stable during times of crisis"*.

This proposal to increase the risk retention level will be resisted strongly by the industry and will, no doubt, be subject to much debate over the coming months.

[2] http://www.cadwalader.com/resources/clients-friends-memos/update-on-the-eus-proposed-regulation-on-securitisation-and-its-potential-impact-on-us-market-participants

The Originator, Sponsor or Original Lender needs to be a Regulated Entity

The Proposed Amendments provide that the originator, sponsor or original lender in a securitisation will need to be a regulated entity[3]. It appears, though it is unclear from the drafting, that the intention is that the retention holder will need to be a regulated entity. If so, this provision could effectively exclude a wide range of institutions that fund themselves through the securitisation market, but are not regulated.

European Securitisation Data Repository

Another Proposed Amendment is the establishment of a data repository for underlying loans in securitisations. This possibility was mentioned in the Working Document; it is intended to enhance market transparency. The originator, sponsor and Securitisation Special Purpose Entity ("**SSPE**") of a securitisation shall also disclose to ESMA, the information about the securitisation that is already required to be disclosed to investors and national regulators under the Commission Proposal.

The Proposed Amendments provide that ESMA shall publish the information on the underlying loans in an anonymised way on a dedicated webpage, which is to be known as the "European Securitisation Data Repository". ESMA is to charge the originator, sponsor and SSPE of a securitisation in order to recoup the costs of setting up and maintaining the European Securitisation Data Repository.

Disclosure Requirements on Investors

The Proposed Amendments also include a provision that investors notify ESMA after buying a securitisation investment, and that the quarterly investor reports required under the Commission Proposal should include *"information on the investors in the securitisation and their ultimate beneficial owner, the size of their investment and to which tranche of the securitisation it relates"*.

The Explanatory Memorandum notes that *"for transparency reasons, disclosure requirements are expanded to information with regard to investors and their beneficial owners, to assure an overview of the market and to know where the transferred risk precipitates"*.

These further requirements are unlikely to be welcomed by investors.

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[3] 'Regulated entity' is defined by reference to Directive 2002/87/EC. The definition in the original version of the Directive (to which the Proposed Amendment refers) means "a credit institution, an insurance undertaking or an investment firm" and so would appear to exclude entities which are not such EU regulated entities. However, in the amended Directive, "regulated entity" means "a credit institution, an insurance undertaking, a reinsurance undertaking, an investment firm, an asset management company or an alternative investment fund manager" , which terms in the amended Directive include entities whose registered office is outside the EU, but who would be required to be regulated if their registered office were in the EU.

Ban on Re-securitisation

A further Proposed Amendment is that the underlying exposures used in a securitisation will not be able to include securitisations. The rationale is that this measure will improve transparency and will strengthen the legislative framework designed to address the risks inherent in securitisation.

We note that re-securitisations will be subject to significantly increased risk weights under the revised Basel securitisation framework, in any event.

Key role for ESMA

Also previously flagged in the Working Document, is a proposal that ESMA should, together with the national securities regulators, be responsible for supervising compliance with the STS criteria and should develop guidelines to ensure a common and consistent understanding of the STS requirements throughout the EU. This is in order to reduce uncertainty in potential interpretation issues, and to encourage a consistent approach across the EU.

Only Regulated Institutional Investors are to be able to Invest in Securitisations

A Proposed Amendment provides that investors in securitisation need to be "institutional investors", which term refers to specific types of EU regulated entities. The Explanatory Memorandum notes that the intention is that only regulated institutional investors should be allowed to take part in the securitisation market, in order to *"exclude the shadow banking sector"*.

The Originator, Sponsor and SSPE in an STS Securitisation need to be established in the EU

The Proposed Amendments provide that the originator, sponsor and SSPE involved in an STS securitisation need to be established in the EU. The Explanatory Memorandum notes that this is *"in order to avoid importing substantial risks from third countries and ensure better supervision."*

No STS Designation for Securitisations Existing Prior to the Regulation Entering into Force

The Commission proposed that securitisation positions outstanding when the Regulation enters into force could be designated as "STS", provided that the securitisation complies with the STS requirements. The Proposed Amendments seek to delete this provision, meaning that the STS designation would not be available to securitisation positions outstanding when the Regulation enters into force. This will be of concern to the securitisation industry, since it was hoped that grandfathering would be available.

No Transfer of STS Certification to a Third Party

The Proposed Amendments prohibit the originator, sponsor or SSPE from transferring the STS certification of securitisations to a third party.

Restrictions on Entities that can be SPVs

The Proposed Amendments provide that SSPEs cannot be established in non-EU countries which: (a) are tax havens (i.e. a country that *"promotes itself as an off-shore financial centre or one in which there are no or nominal taxes*"); (b) lack effective exchange of information with foreign tax authorities; (c) lack legislative, judicial or administrative transparency; (d) have no requirement for a substantive local presence; (e) are listed as a "Non-Cooperative Country and Territory"; or (f) have not signed an agreement to share tax information.

Fines for Non-Compliance

The Commission Proposal provided for Member States to impose sanctions for non-compliance with specified provisions of the Regulation, including maximum administrative fines of "at least EUR 5,000,000". The Proposed Amendments change these provisions to state that the maximum administrative fine of at least EUR 5,000,000 should apply "in the case of a natural person".

Conclusion

In our view, the Proposed Amendments reflect a sceptical view of the securitisation market in general. The proposal to increase the risk retention level from 5% to 20% will be viewed with concern across the European securitisation market. However, the legislative process still has some way to go and it is likely that many of the Proposed Amendments will not find their way into the final version of the Regulation.

Cadwalader will continue to lobby Members of the European Parliament and regulators through its work with industry groups, such as the Loan Market Association. We would encourage anyone interested in commenting to make their views known to the various industry bodies. Alternatively, please do reach out to one of the Cadwalader contacts below.

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

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