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The Securitisation Regulation: an originator perspective

The Securitisation Regulation ("**SR**") (Regulation (EU) 2017/2402) consolidates and enhances existing regulatory rules applicable to securitisations. It also creates direct compliance obligations for originators, original lenders and securitisation special purpose entities ("**SSPEs**"), with sanctions available for non-compliance.

Two important themes arise from the SR which are of note to originators:

- a further increased focus on transparency and disclosure, with a view to enabling investors to meet their new, more rigorous, investor due diligence requirements; and
- new asset selection and credit granting rules.

We have identified seven key issues for originators to consider, which are set out below. This article focusses on standalone securitisation; the application of the SR to ABCP differs in a number of respects and should be considered separately.

1. Grandfathering

The SR will apply to securitisations:

- where the securities are issued on or after 1 January 2019; or
- if the securitisation does not involve the issuance of securities, where new securitisation positions are created on or after 1 January 2019. A "securitisation position" is defined as an exposure to a securitisation.

Pre-1 January 2019 securitisations should therefore generally be grandfathered, but may become subject to the SR if new notes are issued or new securitisation positions are created on or after this date.

As of the date of this article (May 2019), a number of the required technical standards and delegated legislation for interpretation and application of the SR have not yet been adopted or published. This means (among other things) that the templates in the Annexes to Delegated Regulation (EU) 2015/3 (CRA III) (the old "**Article 8b**" templates) will apply as disclosure templates until the technical standards under the SR are adopted (see further below).

2. Supervision and sanctions

The SR contemplates both administrative and criminal sanctions in the case of negligence or intentional infringement. As part of the implementation of the SR, competent authorities in the relevant jurisdiction will acquire supervisory powers over originators, sponsors, original lenders, SSPEs and other parties that are subject to the SR.

Administrative sanctions include public censures, significant fines of up to €5,000,000 (or equivalent currency) or of up to 10% of annual net turnover, and bans which will prevent individuals from exercising management functions. Any sanctions are required to be effective, proportionate and dissuasive.

Criminal sanctions are a possibility depending on each member state's position.

3. Risk retention

The obligation

The SR creates a new, direct requirement on the originator (or sponsor or original lender) to retain a material net economic interest in the securitisation of at least 5%, with penalties for non-compliance. The five methods of holding the risk retention provided for under existing legislation are unchanged.

The originator, sponsor or original lender may agree between themselves which of them will act as the retention holder; in the absence of such agreement, the obligation will fall to the originator. However, originators can take some comfort from the EBA's indication that the failure of the designated retention holder to retain post-closing does not impose an obligation on any other party to subsequently act as risk retention holder.

Who is an originator?

The SR narrows the scope of entities that can be considered as originators for the purposes of complying with the risk retention requirements set out in the SR, by

excluding any entity that has "been established or operates for the sole purpose of securitising exposures"[1].

In assessing whether an entity has been established for the sole purpose of securitising exposures, the following principles must be taken into consideration:

- whether the entity has a business strategy consistent with a broader business enterprise;
- whether the entity has the capacity to meet payment obligations involving material support from capital, assets, fees or other income available to the entity without relying on the exposures being securitised by that entity or on any retained interest; and
- whether the entity has responsible and experienced decision makers to enable the entity to pursue the established business strategy and an adequate corporate governance arrangement.

4. Asset selection

No cherry picking

The SR creates a new prohibition on originators "cherry picking" assets to securitise that are more risky than comparable assets held on the originator's balance sheet. Originators are not permitted to select assets to be transferred to an SSPE with the aim that the transferred assets will suffer greater losses than the retained assets. The relative performance of the transferred and retained assets is measured over the shorter of the lifetime of the transaction or four years.

If there is evidence suggesting a breach of the prohibition, the SR requires the competent authority to investigate. As part of the investigation, the authority will consider any policies and procedures the originator applies to ensure that the securitised assets would not reasonably be expected to lead to higher losses than comparable assets retained on the originator's balance sheet. For sanctions to be imposed the breach needs to have been intentional – there is a safe harbour if it could reasonably have been expected that the performance of the assets would not be significantly different.

Exemptions

There are exemptions to the "no cherry picking" rule. Originators may securitise assets that are expected to perform differently to assets held on balance sheet, provided that this is clearly disclosed to investors, potential investors and authorities.

Originators may also transfer all assets of one type to an SSPE (for example, portfolios of non-performing loans). The effect of this is that no comparable assets will be retained on balance sheet, but the originator will not be in breach of the prohibition provided that the position has been clearly communicated to investors.

Credit granting and customer creditworthiness

Originators, sponsors and original lenders must apply the same credit granting criteria to both securitised and non-securitised assets[2]. Requiring the assessment of the creditworthiness of customers to be conducted in the same way for both securitised and non-securitised assets reinforces the prohibition on securitising assets that are intended to incur higher losses than retained assets.

The SR also creates a new requirement for originators, sponsors and original lenders to have effective systems in place to ensure that customers are only granted credit following a thorough assessment of their creditworthiness. In light of this new obligation, originators, sponsors and original lenders should (if not already required to do so as part of their regulated lending) consider keeping a full record of decisions made in relation to an obligor's creditworthiness and the decision to grant them credit.

In circumstances where an originator purchases exposures from another entity for its own account and then securitises them (ie a "limb (b)" originator), that originator is required to verify that the original lender has fulfilled the credit granting requirements.

5. Ban on re-securitisation and self-certified loans

The SR creates a ban on re-securitisation of already securitised exposures (subject to specific narrow carve outs)[3].

New RMBS transactions of self-certified mortgages originated after 20 March 2014 (when the Mortgage Credit Directive entered into force) are also prohibited[4]. Member states had until March 2016 to transpose the Mortgage Credit Directive (which bans self-certified mortgages) into national law, and so originators will need to be mindful of the prohibition and check local implementation.

6. Transparency and disclosure obligations

The disclosure requirements for originators of public and private securitisations are contained in Article 7(1) of the SR. The annexure schedules of the disclosure regulatory

1. Article 6(1) of the SR.
2. Article 9 of the SR.
3. Article 8 of the SR.
4. Article 9(2) of the SR.

technical standards prepared by ESMA (the "**Disclosure RTS**") provide reporting templates which specify the information that needs to be disclosed at a granular level. The Disclosure RTS have not yet been adopted, however industry expectation is that the final form of the Disclosure RTS will closely resemble the current draft. We have set out a brief summary below, but note that the content requirements are extensive and detailed and should be considered carefully by those responsible for producing the reports.

The content of the information to be disclosed is in most respects the same whether the transaction is a public or a private securitisation. However, where the transaction is a public securitisation, the required information must be uploaded to a securitisation repository registered and supervised by ESMA (or maintained on another website meeting the requirements of the Disclosure RTS, until a registered repository is available).

There is no requirement in a private securitisation to publish information on a repository. For a private securitisation, the required information must be made available to holders of a securitisation position, the relevant competent authority and, on request, to potential investors. There is no guidance at EU level on how the relevant information should be made available to competent authorities. However, some competent authorities have begun to publish guidance and supervisory statements to assist in the relevant jurisdiction. In the UK the Prudential Regulation Authority (the "**PRA**") and the Financial Conduct Authority (the "**FCA**") have issued a joint statement on disclosure reporting for private securitisations. Using the published notification template, a summary of the relevant information must be notified to the FCA or PRA (as applicable, depending on the authority supervising the reporting entity). The full set of information must be made available to the FCA or PRA 'on request'.

What must be disclosed

The disclosure templates are intended to improve disclosure to investors by facilitating standardised reporting of granular level loan data, to assist investors with meeting their due diligence and monitoring requirements. Using the templates, originators must disclose the following.

- Granular information relating to the performance of the underlying exposures, in the form prescribed by the Disclosure RTS.
- All underlying documentation that is essential to understanding the transaction. For public transactions, a copy of the prospectus must be made available. For a private transaction, a transaction summary or an overview of the main features of securitisation must also be provided.
- Investor reports including: (a) the credit quality and performance of the underlying exposures; (b) trigger events which amend the payment waterfall or cause the replacement of any counterparties; and (c) information regarding compliance with risk retention requirements, including the method of retention.
- For public transactions, the information that the originator is required to make public in accordance with insider dealing and market manipulation regulations.
- For private transactions, significant events such as a material breach of obligations, a material change in the structure of the securitisation, material amendments to the transaction documents and loss of STS status (if applicable - see below).

When must disclosure occur

- Information and documentation essential to the understanding of the transaction must be made available before pricing.
- Underlying exposure reporting and investor reports must be provided quarterly.
- Inside information and details of significant events must be disclosed without delay following the occurrence of the relevant event.

Use of the disclosure templates

There are separate templates depending on the type of underlying assets, and the total number of data fields varies from 41 data fields for credit card securitisations to 227 data fields for commercial real estate securitisations. Many fields are mandatory, and where originators and sponsors do not have information available to populate the mandatory fields, it is not clear that the relevant assets can be securitised in accordance with the law.

In an attempt to strike a balance between the need for investors to have sufficient information to meet their diligence requirements and the fact that there may be justifiable reasons why information cannot be provided in some cases, the Disclosure RTS provides for "No Data" options for some of the data fields. By way of example, for RMBS transactions, there are 97 data points to provide, with 89 of those allowing a "No Data" entry. However, it is important to bear in mind that each No Data option relate to a specific reason why information is not available or applicable, and not all of the No Data options are available in each case.

We recommend that originators and sponsors who have not yet established a securitisation transaction under the SR undertake a review of the applicable templates to ensure that the required information is being collected, and that underwriting policies are updated if required.

Transitional arrangements

Until such time as the Disclosure RTS is adopted by the Commission, the SR requires originators to report on the Article 8b templates. The Article 8b asset level templates are similar to those annexed to the Disclosure RTS, but are not the same in every respect. In respect of investor reports, Article 8b did not provide a prescribed format, but rather a list of required content by category.

Many originators have expressed concern about the new disclosure requirements and the period that will be required for compliance. A joint statement issued by the

European Supervisory Authorities acknowledges the concerns expressed by the market, and expects competent authorities to exercise their supervisory powers in relation to disclosure in a "proportionate and risk-based manner".

7. Simple, Transparent and Standardised ("STS") Securitisaitons

The SR creates a concept of Simple, Transparent and Standardised Securitisations. Originators, sponsors and SSPEs can only use the STS designation where the securitisation meets certain requirements and the originator and sponsor have confirmed this by making the required notification to ESMA. A securitisation with the STS label may benefit from preferential capital treatment in the hands of certain categories of regulated investor, and may therefore be more attractive to investors. The originator is ultimately responsible for ensuring compliance with the STS criteria and will be liable under the applicable sanctions regime for any false notification. However, an originator may engage a third party verification agent to certify its compliance with the STS criteria. Where a third party certification has been obtained, this may be offered as evidence that the originator was not negligent when making its STS notification.

We have not set out or discussed the STS criteria in full in this article (please see our previous briefing, *The Securitisation Regulation - step by step* for more detail on the STS criteria), but by way of overview from the perspective of an originator: the STS criteria in general relate to the structure and characteristics of the securitisation, rather than the underlying credit quality of the assets involved. However, there are some asset-level requirements.

In order to qualify as a STS securitisation, the securitised assets must (among other things) be homogeneous in terms of asset type and contain contractually binding and enforceable obligations, with full recourse to debtors (and guarantors, if applicable) as well as having defined periodic payment streams. In order to comply with the transparency requirements, the originator and sponsor must provide information to investors detailing at least five years of historic default and loss performance for assets that are substantially similar to those being securitised. The underwriting standards pursuant to which the underlying exposures are originated, and any material changes from prior underwriting standards, must also be fully disclosed to potential investors without undue delay. The originator or sponsor must provide a liability cash flow model to investors before pricing, outlining the underlying exposures and the payments flowing between the originator, sponsor, investors, other third parties and the SSPE.

Also of interest to originators will be the STS criterion requiring that the originator or original lender must have expertise in originating exposures of a similar nature to those securitised. The servicer must also have expertise in servicing exposures of a similar nature to those securitised, and well-documented and adequate policies, procedures and risk-management controls relating to the servicing of exposures. Third party verification of the STS status of the transaction will require each of the required criteria to be demonstrated to the verifier.

The STS designation is not available to non-EU originators, sponsors and SSPEs, but it is expected that a UK equivalent of the STS framework will exist post-Brexit, so that the label will remain relevant for UK originators.

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