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New EU securitisation framework applicable from 1 January 2019

Insights - 01/06/2018

Introduction

The long-awaited Securitisation Regulation (EU) No 2017/2402 of the European Parliament and of the Council of 12 December 2017 (the **Securitisation Regulation**) entered into force on 17 January 2018 and will apply directly in all Member States from 1 January 2019.

The Securitisation Regulation marks a significant step towards the implementation of the European Union's Capital Markets Union (**CMU**) initiative, which notably aims at providing businesses with a greater choice of funding at lower costs, offering new opportunities for investors and reinforcing the resilience of the financial system. In this context, the Securitisation Regulation aims to restore confidence in the securitisation market, which was considered partly to blame for the 2008 financial crisis, with the goal of unlocking up to EUR 150 billion of additional funding in the European economy by diversifying the source of funding available and creating new investment opportunities for institutional investors.

The Securitisation Regulation applies to institutional investors, originators, sponsors, original lenders and securitisation special purpose entities (**SSPEs**). Its scope is both to (i) lay down a general framework for securitisation (in order to have a uniform regime) and (ii) create a specific framework for simple, transparent and standardised securitisation (**STS**).

General framework for securitisation

Definitions

The Securitisation Regulation helpfully starts by providing a number of useful definitions of all the key concepts of securitisation (for example, defining originator, sponsor, institutional investor, SSPEs, tranche, etc.). Securitisation itself is defined as a transaction or scheme, whereby the credit risk associated with an exposure or a pool of exposures (the **Exposure**) is tranched, and where (i) payments are dependent upon the performance of the Exposure, (ii) the subordination of tranches determines the distribution of losses and (iii) the transaction does not create a "specialised lending exposure" in accordance with article 147(8) of the Credit Requirements Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013.

Importantly, the Securitisation Regulation introduces a ban on "resecuritisation" (defined as a securitisation "where at least one of the underlying Exposures is a securitisation position"), subject to derogations in certain cases.

Uniform non-sectoral regulation

The Securitisation Regulation brings the European regulation of securitisation transactions under one legislative framework, which is a significant shift from the current sectoral and fragmented regulatory landscape which involves applying different legislation depending on the classification of the investor(s).

Obligations on parties involved in securitisation

These harmonised rules relate to three main key requirements set out below (due diligence, risk retention and transparency):

1) Due diligence

The Securitisation Regulation brings in one place the required due diligence and assessments requirements that institutional investors need to run prior to, or when holding, a securitisation position. This will include requirements on institutional investors to verify the following, amongst other things:

- whether the originator, sponsor, or original lender comply with the risk retention requirements (see point 2 below);
- whether the originator, sponsor, or SSPE have, where applicable, made available the necessary information pursuant to the transparency requirements (see point 3 below); and
- whether originators or original lenders, which are not credit institutions or investments firms (or are established in third countries), follow sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing credits which form the underlying Exposure of the securitisation.

2) Risk retention

The requirement to retain at least 5% of material net economic interest has been maintained in the Securitisation Regulation. However, a major change is that it is now a direct obligation for the originator, sponsor or original lender to fulfil this requirement ("direct approach", which complements the existing "indirect approach" of obliging institutional investors to verify this risk retention threshold was satisfied). Where no agreement on this exists between the originator, sponsor or original lender, the originator must retain the material net economic interest, which must be calculated based on the notional value at origination and shall not be subject to any credit-risk mitigation or hedging. The European Banking Authority launched a consultation on draft regulatory technical standards on 15 December 2017 detailing the requirements for originators, sponsors and original lenders on risk retention.

Importantly:

- rules are introduced prohibiting the selection by the originator of lower performance assets to be securitised (ie. assets which are more likely to suffer losses compared to other assets on the originator's balance sheet); and
- the notion of "originator" is further defined to make sure that there will be full compliance with the risk retention rules.

3) Transparency

Originators, sponsors and SSPEs are now bound to make available certain defined information to investors, competent authorities, and where requested, to potential investors. The information that must be disclosed includes, for example, information on the underlying Exposure, the essential documentation used in the transaction (excluding legal opinions) and the final offering document or prospectus used or a transaction summary.

The information to be provided shall be made available by means of a securitisation repository or, where none is registered in accordance with the Securitisation Regulation, by means of a website that needs to fulfil a number of requirements as set out in the Securitisation Regulation.

Importantly, the providers of information will need to make sure that the relevant laws and other obligations relating to the protection of confidentiality of information and the processing of personal data will be complied with.

STS (simple, transparent and standardised) securitisation

The Securitisation Regulation enables certain securitisation products to be designated as STS if they meet specific eligibility criteria relating to simplicity, transparency and standardisation. As a consequence, prudent and diligent investors should be better able to analyse the risks involved in the operation, and could benefit from more favourable regulatory capital requirements (introduced by the Credit Requirements Regulation) when investing in STS securitisation compared to non-STS securitisations. In order for a securitisation to be designated as a STS, a number of characteristics must be met by the securitisation product, amongst others:

- true sale only;
- homogeneity in terms of asset type;
- clear specification requirements for the relevant transaction documentation and obligation to provide a precise liability cash flow model to potential investors;
- no active discretionary portfolio management; and
- no transferable securities in the underlying exposures (other than corporate bonds not listed on a trading venue).

Originators and sponsors wishing to designate their product as a STS are required jointly to notify ESMA that the securitisation meets the STS requirements. Their notification shall include an explanation of how the STS criteria have been complied with, and will be published by ESMA on its website for information purposes.

As per the Securitisation Regulation, the originator, sponsor and SSPE involved in a STS securitisation shall be established in the EU.

The originator, sponsor or SSPE may use an authorised third party (subject to certain conditions in terms of eg remuneration and independence) to assess compliance with the STS criteria. Such delegation, however, does not affect the legal obligations and potential liability of the originators, sponsors or SSPEs, or in the case of institutional investors, their due diligence obligations under the Securitisation Regulation.

New Sanctions Regime

Member States must establish rules for appropriate sanctions and remedial measures which are effectively implemented when originators, sponsors, original lenders or SSPEs fail to comply with the requirements of the Securitisation Regulation. The maximum administrative fines which can be levied are (i) at least EUR 5,000,000 or up to 10% of the total annual net turnover of a legal entity or (ii) at least twice the amount of the benefit derived from the infringement where that benefit can be determined, whilst criminal sanctions are left to the discretion of the Member States.

Impact on the Securitisation market in Luxembourg

As noted above, the Securitisation Regulation will directly apply in Luxembourg, as for all other Member States, from 1 January 2019. The current Luxembourg Securitisation Law of 22 March 2004 may be amended in this context. However, since it currently contains a wider definition of securitisations regulated by that law and not all Luxembourg securitisation structures will be impacted by the Securitisation Regulation, several (more or less stringent) securitisation regimes may co-exist as from 2019 in Luxembourg. A further news flash will be issued in this respect.

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