

# SECURITISATION: REGULATORY FRAMEWORK AND REFORMS

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An outline of the regulatory framework within which UK securitisations operate and a summary of the latest reforms of interest to securitisation lawyers.

The note focuses on EU and domestic reforms having a direct impact on securitisation, CDO and CLO transactions. These include new risk retention requirements, credit ratings reforms and industry-led initiatives promoting transparency and disclosure.

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## CURRENT REGULATORY REGIME

For the purposes of this note, the term **securitisation** includes, unless stated otherwise, **collateralised debt obligations** (CDO) and **collateralised loan obligations** (CLO).

There is (currently) no single regulatory regime covering UK securitisations specifically. Instead, the market is regulated by a number of EU directives and regulations, domestic legislation and the rules of the UK financial regulators. As well as legislative rule-making authorities, there are also market-sponsored bodies that issue guidelines, codes of conduct and other rules that are relevant to securitisation market participants.

However, a harmonised legislative framework for securitisations is in the process of being passed at EU level. On 30 September 2015, the European Commission published a legislative proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised (STS) securitisation (Securitisation Regulation). For further details, see *The Securitisation Regulation*.



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## CONDUCT AND SECURITIES REGULATION

**Note:** This practice note does not cover the relevant requirements under *Regulation (EU) No 648/2012 on OTC derivative transactions, central counterparties and trade repositories* (EMIR) which came into force on 16 August 2012. For further information on EMIR, see *Practice notes, EMIR: overview* and *Hot topics: EMIR*.

While not specifically aimed at securitisations, there are bodies of law which have wide market application, such as those relating to the offer, issuance, listing and trading of debt securities. Transactional lawyers need to be aware of and give consideration to:

- The **Financial Services and Markets Act 2000** (FSMA). Among other things, the FSMA sets out which parties to a transaction need to be **authorised persons** under *FSMA* in order to carry out a **regulated activity** or communicate a **financial promotion**.
- The **Listing Rules, Prospectus Rules and Disclosure Guidance and Transparency Rules** of the **Financial Conduct Authority** (FCA).

These laws and rules are primarily derived from EU legislation (including *Directive 2003/71/EC* (as amended) on the prospectus to be published when debt securities are offered to the public or admitted to trading (**Prospectus Directive**), *Directive 2004/109/EC* (as amended) on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (**Transparency Directive**) and Regulation (EU) No 596/2014 (as amended) on market abuse (**Market Abuse Regulation**)).

The FSMA confers on the FCA the functions set out in Part 6 of FSMA, which include acting as competent authority for the purposes of making the Listing Rules, Prospectus Rules and Disclosure Guidance and Transparency Rules. The FCA (as the **UK Listing Authority**) is responsible for vetting and approving prospectuses for the purposes of the Prospectus Directive as implemented in the UK.

- For information on when a prospectus is required under the FSMA, see *Practice note, When is a prospectus required?*. For an overview of the Prospectus Directive and the content requirements of a prospectus for an issue of debt securities, see *Practice note, Prospectus Directive and debt securities*.
- For an examination of FSMA and the rules relating to authorised persons for the purposes of FSMA, see *Practice notes, FSMA overview* and *Financial promotion: overview*.
- For an overview of the various rules in relation to listing, disclosure and transparency and prospectus requirements, see *Practice notes, Listing debt securities in London* and *Listing, Prospectus, Disclosure and Transparency Rules: overview*.

- For information on what restrictions apply to offering and trading transferable debt securities, and the market practice on offering bonds in the UK, see *Practice note, Selling debt securities: UK selling restrictions*.

Particularly where the **receivables** under a securitisation transaction comprise consumer contracts (see *Practice note, Types of securitisation: Consumer asset-backed securities (ABS)*), transactional lawyers will need to be aware of and give consideration to:

- Restrictions under the *Data Protection Act 1998* and confidentiality laws which impact on the proposed transfer of customer information that accompanies the transfer of receivables. See *Practice notes, Overview of UK data protection regime* and *Data protection issues on commercial transactions*.
- The need for underlying receivables contracts to comply with relevant consumer credit requirements, including those set out in the "*Mortgages and Home Finance: Conduct of Business sourcebook*" of the **FCA Handbook**. See *Practice notes, UK consumer credit regime: overview, Introduction to UK consumer credit regime* and *Mortgage conduct of business regulation: MCOB overview*.
- Regulations governing mortgage book sales to SPVs. Under *Article 61(2)* of the *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544)* (RAO), administering a regulated mortgage contract is a specified activity where the contract was entered into by way of business on or after 31 October 2004. However, the RAO affords an exemption to an unauthorised person who "arranges for another person with permission to administer a regulated mortgage contract, to administer the contract" (*Article 62*). This exclusion applies to an SPV administering a regulated mortgage contract transferred to it under a securitisation transaction (*PERG 4.8.5* and *4.16.4*). For more information, see *Practice note, Regulated activities: mortgage-related activities: Administering a regulated mortgage contract (article 61(2), RAO)*.
- The UK government in 2009 proposed legislation to ensure consumer protections were maintained when a mortgage book was sold by a lender to an unregulated entity, such as a securitisation SPV. HM Treasury published a consultation on, among other things, revising the definition of the regulated activity of administering a regulated mortgage contract to bring the onward sale of mortgage portfolios within scope of regulation. This activity would be expanded to include all firms that exercise specified rights in relation to regulated mortgage contracts, such as changing interest rates or taking action to repossess a property against a borrower. Accordingly, many of the (currently unregulated) mortgage administration functions of a securitisation servicer (see *Practice note, Securitisation: overview: Servicer*) would become regulated by the FCA.

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- While the then UK government stated that it intended to proceed with the proposals following the consultation, no legislation in this regard has been published so far. For further details, see [Legal update, Mortgage book sale proposal to maintain consumer protections](#).

## CREDIT RATINGS AND CRA REGULATION

Most **credit rating agencies** (CRAs) operate under the "issuer-pays" model under which the issuer of a debt instrument will solicit and then pay for the ratings of their own debt instruments. To mitigate conflicts arising from this remuneration structure and avoid over-reliance on credit ratings by investors, the [Regulation \(EC\) No 1060/2009](#) of the European Parliament and of the Council of 16 September 2009 on credit rating agencies (CRA Regulation) introduced a number of measures to regulate market practice (see [Practice note, EU Regulation on credit rating agencies](#)).

The CRA Regulation provides that EU regulated firms (such as credit institutions, investment firms and insurance companies) cannot use credit ratings for regulatory purposes unless such ratings are issued by CRAs established in the EU and registered in accordance with the CRA Regulation or such ratings (if issued by CRAs established in a third country) are endorsed by a CRA established in the EU or the third country CRA is certified by the European Securities and Markets Authority (subject to other specified conditions being met).

The CRA Regulation has been amended since it came into force in the wake of the financial crisis of 2009, notably, in May 2011 by Regulation (EU) No 513/2011 (commonly known as [CRA II](#)) in which responsibility for the registration and ongoing supervision of EU-based CRAs was transferred (from relevant national competent authorities) to the European Securities and Markets Authority (ESMA) and in June 2013 by [Regulation \(EU\) No 462/2013](#) (commonly known as [CRA III](#)) which introduced new requirements for structured finance instruments. [CRA III](#) was published in the Official Journal of the European Union (OJ) on 31 May 2013 and came into force on 20 June 2013 ([Legal update, CRA III legislation published in Official Journal](#)).

### CRA Regulation

The CRA Regulation, being an EU Regulation (rather than an EU Directive), is binding on all EU member states without the need for national implementation or transposition (apart from certain discretion granted to national competent authorities with respect to the interpretation and application of the CRA Regulation).

In relation to structured finance instruments which are defined as financial instruments or assets resulting from a securitisation, the key requirements under the CRA Regulation include:

- **Dual ratings:** An issuer or a related third party that intends to solicit a credit rating on a structured finance instrument must obtain ratings from at least two CRAs on that instrument. ([Article 8c, CRA Regulation](#).)

- **Use of "smaller" CRAs:** Where an issuer or a "related third party" intends to appoint at least two CRAs, it must "consider" the appointment of at least one of those CRAs from among agencies that have no more than a 10% share of the structured finance credit ratings market. A "related third party" means the originator, arranger, sponsor, servicer or any other party that interacts with a CRA on behalf of the issuer, including any person directly or indirectly linked to the issuer by control. ESMA is required to publish annually a list of registered CRAs, indicating their total market share and the types of credit ratings issued (For information on the latest market share figures published by ESMA, see [Practice note, CRAs and credit ratings: EU regulation: Use of multiple CRAs](#).)
- It is for the issuer or a related third party to evaluate the market share of the relevant CRA (taking into account the information published by ESMA) and where no such "smaller" CRA is appointed, this must be documented.

(Article 8d, CRA Regulation)

- **Mandatory rotation of CRAs every four years for rating re-securitisations:** CRAs are prevented from issuing ratings on re-securitisations with underlying assets from the same originator, for more than four consecutive years.

The mandatory rotation rule does not apply to:

- "smaller" CRAs (essentially, those with fewer than 50 employees or an annual turnover of less than EUR 10 million, both at group level); or
- issuers employing at least four CRAs, each rating more than 10% of the total number of outstanding rated re-securitisations (comprising underlying assets pooled from the same originator).

(Article 6b, CRA Regulation.)

- **Public disclosure:** The issuer, the originator and the sponsor are jointly responsible for making specific information publicly available via a website (referred to in the RTS (see below) as the SFIs website and also known as the European Rating Platform or ERP) established by ESMA and on an ongoing basis. ([Article 8b, CRA Regulation](#))

Details of these disclosure requirements, including content, format and reporting frequency, are set out in the regulatory technical standards (RTS) in the form of Commission Delegated Regulation (EU) 2015/3 of 30 September 2014 which was published on the Official Journal of the European Union on 6 January 2015.

The RTS specifies structured finance instruments that are subject to these disclosure requirements, which cover the following instruments issued after 26 January 2015: RMBS; CMBS; ABS backed by loans to small and medium sized enterprises (SME CLOs); ABS backed by auto loans; ABS backed by consumer loans; ABS backed by credit card loans; and ABS backed by leases.

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The following data is required to be provided under the RTS:

- loan-level information using standardised templates;
- a copy of the prospectus, closing documents (excluding legal opinions) and other transaction and bond documents (including a detailed description of the waterfall of payments of the structured finance instrument);
- investor reports containing specified information; and
- where a prospectus is not required to be published under the Prospectus Directive, a transaction summary (including structure diagrams illustrating the transaction, transaction triggers, credit enhancement and liquidity support features, cash flows and ownership structures).

(Article 3, Commission Delegated Regulation)

Of particular note to structured finance specialists are the changes to early versions of the RTS relating to the disclosure requirements for structured finance instruments. ESMA, in its final report on the RTS, notes that the RTS incorporates, where possible, existing disclosure and reporting requirements adopted by the European Central Bank (ECB) and the Bank of England (BoE) to avoid duplication and overlap. For information on the ECB's and BoE's disclosure and reporting requirements, see [Practice note, Securitisation: eligible collateral for central bank operations](#).

On 20 March 2015, the European Securities and Markets Authority (ESMA) published a call for evidence (ESMA/2015/558) on the extension of the disclosure requirements in CRA III. It is considering extending the disclosure requirements to private and bilateral transactions in structured finance instruments (SFIs). For more information, see [Legal update, ESMA calls for evidence on extending disclosure requirements to private and bilateral transactions for structured finance instruments](#).

- **Statutory footing to sue culpable CRAs:** The CRA Regulation is supported by the imposition of a civil liability burden on the rating agencies. CRA III inserts a new Article 35a into the CRA Regulation, enabling investors (even in the absence of a contractual relationship with the rating agencies) and issuers to pursue a claim for damages against a CRA for infringing the CRA Regulation deliberately or through its gross negligence.

Member states are given the power to interpret and apply certain terms of the CRA Regulation and, in the [Credit Rating Agencies \(Civil Liability\) Regulations 2013 \(SI 2013/1637\)](#) (CRA Civil Liability Regulations), the Treasury has defined "gross negligence" as being "reckless" as to whether an infringement of the CRA Regulation has occurred. "Reckless" is defined as acting "without caring whether an infringement occurs". The CRA Civil Liability Regulations came into force on 25 July 2013.

For more information, see [Practice note, CRAs and credit ratings: UK regulation: Credit Rating Agencies \(Civil Liability\) Regulations 2013](#) and [Legal update, Credit Rating Agencies \(Civil Liability\) Regulations 2013 \(SI 2013/1637\) published](#).

The RTS is stated to apply directly in all EU member states from 1 January 2017. However, ESMA announced on 27 April 2016 that it was experiencing delays in setting up the SFIs website and in formulating the technical instructions (which it was required to issue by 1 July 2016) that reporting entities would need to follow in order to comply with the disclosure requirements under Article 8(b). ESMA stated that it was unlikely that the website would be available to reporting entities by 1 January 2017 or that ESMA would be in a position to publish the technical instructions by 1 July 2016 (there have been no further updates from ESMA since), ([Legal update, ESMA update on reporting structured finance instruments information under CRA Regulation](#)).

For background on the development of the RTS, see [Legal updates](#):

- [ESMA discussion paper on draft RTS under CRA III Regulation](#);
- [ESMA consults on CRA III Regulation implementation](#);
- [ESMA final draft RTS under CRA III](#);
- [European Commission adopts three Delegated Regulations on CRA III regulatory technical standards](#).
- [Delegated Regulations on CRA III RTS published in Official Journal](#).

Further reading on the CRA Regulation and credit ratings

- For more information on the role of credit rating agencies in a securitisation, see [Practice note, Securitisation: overview: Rating agencies](#) and [box, The credit rating process in a securitisation](#).
- For more information on UK implementation of the CRA Regulation, see [Practice note, CRAs and credit ratings: UK regulation: UK implementation of EU legislation on CRAs](#).
- For information on the regulatory framework of the CRA Regulation (as amended), see [Practice notes](#):
  - [CRAs and credit ratings: EU regulation](#);
  - [Credit ratings: CRA Regulation](#).
  - [CRA III](#).
  - [CRD IV: Capital Requirements Regulation \(CRR\): Reliance on external ratings](#).
- For information on credit ratings generally, see [Practice note, Credit ratings](#).



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## SECURITIES LABELLING: PRIME COLLATERALISED SECURITIES

Prime Collateralised Securities (PCS), which is an industry-led organisation, was launched in June 2012 to develop a label for high quality securitisations that meet certain eligibility criteria for transparency, quality and simplicity ([Legal update, New Prime Collateralised Securities \(PCS\) securitisation label](#)). Provided the relevant eligibility criteria are met, issuers are able to apply for the label, for a fee, and will be subject to ongoing obligations if the label is given. There are, among others, asset specific eligibility criteria and jurisdiction specific criteria. In relation to asset specific criteria, the following asset categories are generally eligible (provided the conditions for each category are met):

- European residential mortgage loans.
- Auto loans.
- Auto leases.
- Auto dealer floorplan loans.
- Consumer loans.
- Consumer leases.
- Credit card receivables.
- Loans to small and medium-sized enterprises.

Some asset classes are excluded from being eligible, including CMBS, CDOs, synthetic securitisations, re-securitisations and non-European residential mortgages.

PCS labels do not replace credit ratings. Indeed, the current PCS eligibility criteria include the requirement for a security to have been rated by at least two CRAs established in the EU and registered under the CRA Regulation and to be the most senior tranche in a securitisation capital structure. For more on securitisation tranches, see [Practice note, Securitisation: overview: Tranching](#).

Any securitisations that meet the PCS eligibility criteria at the time of request for a PCS label will be, in principle, eligible. Therefore, securitisations issued prior to the creation of PCS will be capable of obtaining a PCS label if they meet the PCS eligibility criteria. PCS granted its first label in November 2012 (to a Norwegian auto loan asset-backed transaction).

## SECURITISATION AND THE CRD

The EU's current capital requirements legislation for credit institutions and investment firms comprises:

- Capital Requirements Directive 2013/36/EU ([Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC](#)) (often referred to as the CRD IV Directive or CRD IV).

- Capital Requirements Regulation 648/2013 ([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](#)) (known as the CRR).

The [CRD IV](#) package (the CRD IV Directive and the CRR) represents a comprehensive reform of the EU's prudential requirements for credit institutions and investment firms, as well as requirements relating more generally to credit institutions; its primary objective is to implement in the EU the Basel III reforms finalised by the Basel Committee on Banking Supervision (BCBS) in December 2010. Prior to the CRD IV reform, the regulatory capital requirements for credit institutions and investment firms were governed by EU Directives [2006/48/EC](#) and [2006/49/EC](#), which together were known as the CRD, as subsequently amended a number of times, notably by Directive [2009/111/EC](#) (known as the CRD II) and by Directive [2010/76/EU](#) (known as the CRD III). CRD (as amended by CRD II and CRD III) has been repealed by CRD IV.

With respect to securitisations, of most relevance are those provisions found in Part Three, Title II, Chapter 5 (Articles 242 to 270) of the CRR which contains the general provisions on securitisation (e.g. calculation of capital requirements for securitisation positions) and Part Five (Articles 404-410) of the CRR which contains the securitisation risk retention requirements. These are considered elsewhere in this note (see [Risk retention](#)).

For background information on CRD II's effect on securitisations, see [Practice notes, CRD II: Securitisation practices](#) and [UK implementation of CRD II: Securitisation practices](#).

For further information on CRD III's impact on securitisation, see [Practice note, CRD III: CRD III capital requirements](#).

The CRD IV Directive and CRR were published in the Official Journal of the European Union on 27 June 2013 and came into force on 28 June 2013 and 17 July 2013, respectively. The CRD IV Directive was required to be implemented by member states by 31 December 2013 (with certain limited exceptions) and the CRR (being an EU Regulation) applied directly in all member states from 1 January 2014 (with certain limited exceptions).

## Further reading

A detailed examination of regulatory capital requirements is outside the scope of this note. For further information on the CRD IV Directive, the CRR and capital requirements reform generally, see Practice notes:

- [CRD reform: overview](#).
- [Hot topics: CRD IV](#).
- [Hot topics: UK implementation of CRD IV](#).
- [CRD IV: CRD IV Directive](#).
- [CRD IV: Capital Requirements Regulation \(CRR\)](#).

## RISK RETENTION

**Note:** The following section focuses on the risk retention requirements under the [CRR](#). Article 17 of the European Union Alternative Investment Fund Managers Directive (*Directive 2011/61/EU*) (as supplemented by Section 5 of Chapter III of Commission Delegated Regulation (EU) No 231/2013) (AIFMD) and Article 135(2) of the European Union Solvency II Directive 2009/138/EC (as supplemented by Articles 254-257 of Commission Delegated Regulation (EU) No 2015/35) (Solvency II) contain requirements similar to those set out in Articles 404 – 410 of the CRR discussed below and apply, respectively, to EEA regulated alternative investment fund managers and EEA regulated insurance/reinsurance undertakings. While such requirements are similar to those in the CRR, they are not identical and, in particular, additional due diligence obligations apply to relevant alternative investment fund managers and insurance and reinsurance companies. Those requirements under the AIFMD and Solvency II are outside the scope of this practice note.

The following section should also be read alongside current EU proposals to overhaul the legislative framework for securitisations (including further revisions to and restatement of the current separate risk retention regimes (including that under the CRR as well as those under the AIFMD and Solvency II), which will be replaced by the new proposals once they come into force). For details, see [The Securitisation Regulation](#).

Rules on the retention of net economic interest and other requirements related to exposures to transferred credit risk have applied (in one form or another) to all new securitisations issued on or since 1 January 2011 (risk retention rules).

The risk retention rules for EU credit institutions and investment firms were initially proposed by the European Commission in July 2008 ([Legal update, European Commission publishes response to consultation on amending the CRD together with short additional consultation](#)). This was during the height of the financial crisis and the original proposals for a 10% retention of an economic interest were subsequently reduced to 5% by the time they were enacted under Article 122a of Directive 2006/48/EC (inserted by CRD II).

The risk retention rules are now laid down in Part Five, Titles I to III of the CRR (Articles 404 to 409) and are supplemented by detailed technical standards set out in Commission Delegated Regulation (EU) No 625/2014 and Commission Implementing Regulation (EU) No 602/2014.

Article 404 of the CRR states that the risk retention rules in Articles 405 to 409 of the CRR apply to all 'new' securitisations issued from 1 January 2011 (being the date from which the risk retention rules under Article 122a of the CRD came into force) and to all existing securitisations where new underlying exposures are added or substituted after 31 December 2014.

For more information on the CRR, see [Practice note, CRD IV: Capital Requirements Regulation \(CRR\)](#), of which [Part Five: Exposures to transferred credit risk \(Articles 404 to 410\)](#) refers specifically to the risk retention rules.

### Retention, disclosure and due diligence

While commonly referred to as the risk retention rules, in addition to the retention of a specified net economic interest by the originator, the sponsor or the original lender of a securitisation (so that it will have "skin-in-the-game"), Articles 404 to 409 of the CRR also contain other requirements which include disclosure requirements imposed on EU regulated institutions when acting as an originator, sponsor or original lender of the securitisation and due diligence requirements imposed on EU credit institutions and investment firms investing in the securitisation. The retention requirement is to address directly the conflicts of interest created by misaligned incentives within the securitisation chain, whereas the disclosure and due diligence requirements are to address information asymmetry within the securitisation process by increasing transparency of the securitisation structure.

### Retention (Article 405)

Article 405 of the CRR requires that an EU credit institution or investment firm (other than when acting as the originator, sponsor or original lender (each, a retention holder)) and consolidated group affiliates thereof (each, a CRR investor) may only be exposed to the credit risk of a securitisation position if the retention holder has explicitly disclosed to the CRR investor that the retention holder will retain a material net economic interest in the transaction of not less than 5%. The retained material net economic interest must not be split amongst different types of retainer, that is, it can only be held by an originator (or multiple originators), a sponsor (or multiple sponsors) or a sponsor (or multiple sponsors); it cannot be held e.g. by an originator and a sponsor (Article 3(1) of Regulation 625/2014).

There are five specified methods by which the economic interest must be calculated and retained, of which a retention holder may only select one.

Broadly, the five risk retention options are:

- **Vertical slice** - retention of at least 5% of the nominal value of each of the tranches (e.g. class of notes) sold or transferred to investors.
- **Originator's interest (revolving exposures)** - retention of an interest in revolving assets equal to at least 5% of the nominal value of the securitised portfolio.
- **On-balance sheet** - retention of randomly selected assets that would otherwise have been included in the portfolio, equal to at least 5% of the nominal value of the securitised portfolio, provided selection is made from a pool comprising not less than 100 assets.

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- **First loss (tranche)** - retention of the most subordinated tranche(s) (in reverse order of priority and having at least the same maturity as the non-retained tranches) equal to at least 5% of the nominal value of the securitised portfolio.
- **First loss (exposure)** - retention of at least 5% of the nominal value of each securitised asset.

Once a particular option has been used, it can only be changed for a different option in exceptional circumstances and provided the change is not used as a way of reducing the retention amount (Article 10(1)(d) of Regulation 625/2014).

The relevant net economic interest:

- Is required to be retained for the life of the transaction.
- Must be measured at the time the assets are securitised, rather than when they were created.
- Once retained, may not be sold or subjected to credit risk mitigation, shorting or hedging.
- Once retained, may be used as collateral for secured funding purposes, provided this does not result in a transfer of the credit risk of retained exposures or securitisation positions to a third party.

Government and central bank-backed securitisations are exempt from the risk retention requirements.

## Disclosure (Article 409)

Article 409 of the CRR (as supplemented by Article 22 of Commission Delegated Regulation 625/2014) requires the retention holders to make specified disclosures to investors, which include:

- The retention holder's identity.
- The capacity in which it is holding the retention.
- The retention method (one of the five under Article 405) that is being used.

Such disclosures must be:

- Documented and made publicly available (it will suffice for these purposes to include the disclosures in the offering documents).
- Confirmed at least annually and, in any event, upon the breach of the retention commitment or of obligations under the transaction documents or when there has been a material change to the performance of the securitisation position, risk characteristics of the securitisation or underlying portfolio.

Further, Article 409 of the CRR also requires the retention holder to provide potential investors with readily available access to:

- All materially relevant data on the credit quality and performance of the individual underlying assets.

- Cash flows and collateral supporting the underlying assets.
- Whatever information is necessary to allow investors to conduct effective stress tests on the cash flows and collateral values supporting the underlying assets.

## Due diligence (Article 406)

Article 406 of the CRR imposes due diligence and monitoring requirements on CRR investors investing in (or exposed to) a securitisation position.

Prior to any investment, CRR investors (or transaction parties that are EU credit institutions or investment firms exposed to the credit risk of a securitised asset or securitisation position, such as liquidity facility providers, hedge counterparties or credit protection sellers) must be in a position to demonstrate a full understanding of the transaction's structure and of the underlying portfolio, including:

- The risk retention mechanism applied to the particular transaction and the information disclosed to it by the originator, sponsor or original lender in respect of that retention.
- The risk profile of the securitisation position it will be taking or be exposed to, which will require an assessment of, among other features, tranche seniority levels, cash flow profile, historical performance of similar tranches and credit enhancements.
- The most appropriate and material characteristics shaping the risk profile of the assets underlying the securitisation position (including by comparison with other asset classes).
- The track record of the originator or sponsor in relation to prior securitisations of the same asset class to which the securitised exposure belongs.
- The statements and disclosures made by or on behalf of the originator or sponsor in relation to due diligence carried out on the portfolio assets and to the quality and valuation methodologies of any collateral supporting those assets.
- All key structural features of the transaction on which the performance of the securitisation position is dependant, including derivative instruments, guarantees, the **payment waterfall**, letters of credit, liquidity enhancement and other forms of **credit enhancement** and support, market value triggers (in relation to non-cashflow structures) and bespoke definitions relating to default.

Parties subject to these provisions are permitted to outsource some of the mechanical or operational aspects of complying with Article 406 of the CRR, provided they retain ultimate responsibility and control of the process. However, the obligation to understand the securitisation risks to which a party is exposed will still apply to the party, regardless of any such outsourcing.

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In addition, ongoing monitoring obligations require relevant parties keep themselves informed, at least annually, of their compliance with Article 406 of the CRR in the light of any changes to the risk profile of their investment or exposure over the course of its life. More frequent reviews will be required:

- In the event of any breaches of contractual obligations relating to the securitisation.
- Following a material change in structural features affecting the performance of their investment or the risk characteristics of their investment or of the transaction's underlying assets.

## Failure to comply (Article 407)

Article 407 of the CRR (as supplemented by Commission Implementing Regulation 602/2014) sets out the regulatory penalties on CRR investors that fail to comply with Articles 405, 406 or 409 in any material respect by reason of their negligence or omission. Competent authorities are empowered to impose proportionate additional risk weights against non-compliant securitisation positions which may be between 250% and 1250%, which means that the CRR investor in question will need to hold additional capital with respect to any such securitisation positions.

## Origination (Article 408)

Article 408 of the CRR requires sponsors and originators to apply the same credit-scoring criteria to assets destined for securitisation as they do to assets that are to be held on their balance sheets. There should be no distinction in the thresholds for granting credit as between securitised and non-securitised receivables. The purpose of this provision is to ensure there is no distinction between 'originate-to-distribute' and 'originate-to-hold' business models.

## Managed CLOs: who qualifies as "sponsor" under Article 122a?

Under the original rules of Article 122a of the CRD, the definitions of "originator", "sponsor" or "original lender" did not capture a portfolio manager of a managed CLO, the very party which market practice had hitherto typically demanded should have some "skin-in-the-game". While that was understandable in so far as the "originator" and "original lender" definitions were concerned, it was less so in relation to the definition of "sponsor".

To qualify as a sponsor under Article 122a, one had to be a credit institution; thus excluding most portfolio managers with respect to managed CLOs. This problem is specific to managed CLOs because (unlike portfolio assets sold by a portfolio manager to a special purpose vehicle (SPV) under a balance sheet CLO, for which the portfolio manager would qualify as an "originator") the portfolio assets in a managed CLO are purchased by the SPV from multiple sellers in the market; they do not emanate from an originating portfolio manager's balance sheet.

For information on CLO portfolio managers, legacy "skin-in-the-game" practices and arbitrage or balance sheet CLO portfolios, see the [Portfolio manager](#) and [Portfolio management: available options](#) sections of [Practice note, Collateralised debt obligations \(CDOs\): overview](#).

In response to market feedback, the then Committee of European Banking Supervisors (CEBS) published a set of guidelines in December 2010 to assist with the interpretation and implementation of Article 122a (CEBS Guidelines). This was followed, nine months later, by the European Banking Authority (EBA, and the successor to CEBS) publishing a question and answer (Q&A) paper on issues arising from the CEBS Guidelines. The Q&A addressed a number of questions raised by competent authorities and market participants seeking clarification on the CEBS Guidelines and/or further guidance on Article 122a. For more on the CEBS Guidelines and the EBA Q&A, see [Legal updates, CEBS guidelines to Article 122a of the CRD](#) and [EBA Q&A on Article 122a of the CRD](#).

According to the CEBS Guidelines as supplemented by the EBA Q&A:

- Any risk retaining fund (including an originating SPV) must not be controlled or managed by the portfolio manager but must have a role in structuring the transaction and in the selection of assets for inclusion in the portfolio; thereby ensuring an optimal alignment of interests with investors. Alternatively, the retention holder could be the portfolio manager itself or the most subordinated investor in the issuer's capital structure. This guidance was helpful in determining the identity of the equity retention holder where a portion of the portfolio was purchased from a variety of sellers (such as in an arbitrage or managed CLO) rather than having been originated by a party to the securitisation or CLO transaction.
- "An originator/sponsor in a transaction can be appointed as the appropriate party to retain the 5% exposure to the whole transaction as long as this originator/sponsor has provided the majority of the portfolio in the securitisation transaction and is involved in structuring the transaction, selecting the initial portfolio and defining the eligibility criteria and tests".

## Managed CLOs: who qualifies as "sponsor" under the CRR?

Together with Article 122a's replacement by the CRR, the CEBS Guidelines and the EBA Q&A were themselves replaced on 1 January 2014 by regulatory technical standards (RTS) and implementing technical standards (ITS) promulgated under the CRR.

Drafts of the RTS and ITS were first published by the EBA in May 2013 together with a consultation paper (EBA/CP/2013/14) on the securitisation retention rules, as recast under the CRR ([Legal update, EBA consults on technical standards on securitisation v rules](#)). Of particular significance for managed CLOs were the changes to the guidance relating to the interpretation of "sponsor" for the purposes of determining which



parties were able to hold the net economic interest. Whereas the CEBS Guidelines on the Article 122a requirements interpreted "sponsor" widely enough to capture any party whose interests were most aligned to those of investors (for example, an 'equity' investor having a role in structuring the transaction and in the selection of assets for inclusion in the portfolio), the draft RTS did not have equivalent provisions.

Although the [CRR](#) has broadened the meaning of "sponsor" which now encompasses not only credit institutions but also investment firms that are regulated by the [Markets in Financial Instruments Directive \(2004/39/EC\)](#) (MiFID) (as subsequently amended by [Directive 2007/44/EC](#) and [Directive 2008/10/EC](#)), the EBA acknowledged in the draft RTS that most CLO managers were too thinly capitalised to absorb the 5% risk retention required by the CRR and (with their ability to arrange for an equity investor to assume the portfolio management duties in return for taking up the retention having been taken away) "[t]his could potentially translate in the long term into a modification of the currently existing managed CLO model".

In addition, non-EU portfolio managers (such as US managers) will not be able to comply with the new definition of "sponsor" as they will not be MiFID-regulated. For more information on how the proposals may impact US transaction parties in a European managed CLO, see [Legal update, EU Risk Retention Change Could Impact US CLO Investors and Issuers](#).

## Final RTS and next steps

Final drafts of the RTS and ITS (EBA/RTS/2013/12 and EBA/ITS/2013/08) were published on 17 December 2013 ([Legal update, EBA final draft technical standards on securitisation retention rules](#)). Notable changes between the May 2013 and December 2013 versions of the RTS include:

- The ability to retain risk on an unfunded basis is limited, by Article 4(2) of the final RTS, to credit institutions. Other risk retainers wishing to meet the retention requirements on a synthetic or contingent basis (through the use of guarantees or derivatives, for example) will have to post cash collateral in support of their obligation to retain a net economic interest.
- Final RTS Articles 5(1)(c) and 8(1)(b) provide for additional ways in which risk retention can be met under two of the methods permitted under the Article 405(1) of the CRR (retention of a vertically tranching note (under the vertical slice category) and overcollateralization of tranches (under the first loss (notes) category)).
- Where there are multiple originators, the risk retention requirement is no longer limited to each originator retaining a pro rata share of the 5% interest. It is now possible for a single originator to retain the full 5% provided it established the securitisation and:
  - is managing the securitisation; or
  - has contributed over 50% of the securitised assets.

- Where there are multiple sponsors, the retention requirement can be satisfied at sponsor level by:
  - the sponsor whose economic interest is most appropriately aligned with investors; or
  - each sponsor pro rata to the total number of sponsors.

In its response to consultation feedback, the EBA confirmed there would be no grandfathering for transactions that were executed (in compliance with Article 122a CRD) between 1 January 2011 and 31 December 2013. However, the CEBS Guidelines on Article 122a compliance will remain effective for the purposes of assessing:

- Whether additional risk weights should be applied in cases of material breach of Articles 405, 406 or 409 of the CRR in relation to transactions issued during that 3 year period.
- How to interpret substitution of exposures made after December 2014 in respect of transactions issued before 1 January 2011.

The final RTS were subsequently adopted by the European Commission without objection (subject to minor corrections) in March 2014 and published (in the form of European Commission Delegated Regulation (Regulation 625/2014)) in the OJ on 13 June 2014 ([Legal update, Delegated Regulation on RTS relating to securitisation retention rules published in OJ](#)). The Delegated Regulation came into force on 3 July 2014 but note that the CRR's risk retention framework has been in force since the beginning of 2014.

Regulation 625/2014 has subsequently been subject to relatively minor editorial corrections by way of another Commission Delegated Regulation (Regulation 2015/1798) (which was published in the OJ on 8 October 2015) ([Legal updates, European Commission adopts amending Delegated Regulation on RTS relating to securitisation retention rules and Delegated Regulation correcting CRD IV RTS published in OJ](#)).

## EBA annual reports on risk retention rules

Article 410(1) of the CRR mandates the EBA to report annually to the European Commission on the measures taken and compliance by competent authorities with Articles 405 to 409 of the CRR.

So far the EBA has published three such annual reports. The latest annual report was published on 12 April 2016, in which the EBA has identified a number of general best practices for national competent authorities to adopt in a proportionate way, including:

- Dedicating sufficient resources, and establish dedicated teams of specialists with expert knowledge of securitisation, to ensure compliance with the risk retention, due diligence and disclosure requirements.
- Developing specific formal methodologies and procedures for assessing, documenting and recording compliance with the applicable rules, with an enhanced element of on-site verification as necessary.

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- Defining specific internal controls required from originator and investor institutions to ensure compliance with the requirements.

## Capital adequacy

Firms subject to financial services regulation (such as credit institutions and investment firms) are typically required to hold a minimum amount of capital (essentially equity, certain reserves and various forms of **subordinated debt**) as measured against the value of their assets. Such capital requirements (referred to as "own funds" under the CRR) are intended to ensure the ongoing solvency of the relevant firms which in turn contributes to protecting the stability of the financial system as a whole.

Given the risks and potential losses associated with holding a securitisation position, there are stringent capital requirements for participating and/or investing in securitisations.

Detailed provisions apply to the quantification and measurement of capital required to be held in the context of securitisation. These requirements are complex and need to be considered in the context of the particular securitisation activities carried on by any financial institution, whether as originator, intermediary or investor. For information on the capital adequacy considerations that motivate various parties to a securitisation, see [Practice note, Structured finance: overview: Capital adequacy considerations](#).

## SIGNIFICANT RISK TRANSFERS

In a typical securitisation, a firm would sell the relevant assets to be securitised to a special purpose vehicle established for such purposes so that such assets would no longer be recorded in the selling firm's balance sheet or required to be included in the firm's regulatory returns. Accordingly, the selling firm would be able to reduce the amount of capital it needs to hold (with respect to those assets sold/securitised) and the associated expense, or use such capital (that has been released) to create new business.

However, credit institutions and investment firms are only able to attain such regulatory capital relief by way of securitisation where there is a significant risk transfer (SRT), that is, significant credit risk associated with the securitised exposures is considered to have been transferred to third parties. Articles 243 and 244 of the [CRR](#) set out the SRT provisions, whereby for a securitisation that falls within one of the options specified therein, SRT is deemed to have been met and the originator institution of a securitisation may exclude the securitised exposures from the calculation of its regulatory capital requirements. Further, Articles 243 and 244 allow national competent authorities to grant permission to an originator to make its own assessment of SRT provided that the reduction of capital requirements which the originator achieves by the securitisation is justified by a commensurate transfer

of credit risk to third parties. For information on these detailed criteria, see [Practice note, Structured finance: overview: Capital adequacy issues for the originator](#).

In the UK, the [Prudential Regulation Authority](#) (PRA) requires an originator institution to notify, one month after the transaction, the PRA of each transaction where it wishes to rely on the "deemed" SRT under Article 243 or 244. Where the PRA finds that the criteria for such "deemed" SRT are not met, the originator will not be able to recognise any capital relief. Firms may also apply to the PRA for permission to make their own assessment of SRT (that is, without relying on Articles 243 and 244); where the PRA grants permission for multiple transactions, that permission will cover a defined scope of potential transactions, which will enable a firm (within certain limits) to carry out these transactions without notifying the PRA in each individual instance.

On 19 December 2013, the PRA issued a policy statement containing the final rules and supervisory statements on implementing the CRD IV package of reforms ([Legal update, PRA policy statement on implementing CRD IV](#)). It included [PRA Supervisory Statement SS9/13 Credit risk – Securitisation](#). The statement's primary focus is on the PRA's expectations of firms claiming SRT through securitisation under Article 243 or 244 of the CRR. SS9/13 outlines a number of issues relevant to the determination of whether the capital relief achieved through securitisation is matched by a commensurate transfer of risk to third parties. SS9/13 also provides guidance on notification and permission processes relating to the SRT.

## SRT guidelines

The EBA is mandated by the CRR to issue guidelines on the specific cases where the possible reduction to risk-weighted exposure amounts is not justified by a commensurate transfer of credit risk to third parties. The mandate also extends to the use firms make of permissions granted to originator institutions by competent authorities to consider significant credit risk as having been transferred, provided certain conditions are satisfied.

Following an initial consultation on proposed guidelines on SRT for securitisation transactions (EBA/CP/2013/45), the EBA published a final set of guidelines in July 2014 (EBA/GL/2014/05) which include requirements for:

- Originator institutions when engaging in securitisation transactions for SRT.
- Competent authorities to assess transactions for which the originator institutions claim SRT.
- Competent authorities when assessing whether commensurate credit risk has been transferred to independent third parties.

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For further details, see [Legal updates, EBA consults on guidelines on significant risk transfer for securitisation transactions](#) and [EBA final guidelines on significant risk transfer for securitisation transactions](#). The EBA will provide advice to the European Commission by 31 December 2017 on whether a binding technical standard is required on SRT.

On 24 March 2016, the European Central Bank (ECB) published a letter containing public guidance on the recognition of SRT for securitisation transactions ([Legal update, ECB supervisory board guidance on recognition of significant credit risk transfer for securitisation transactions](#)). The guidance lays down the procedure to be followed by significant supervised entities (as defined in Article 2(16) of the Single Supervisory Mechanism Regulation (Regulation 468/2014)) when acting as originator institutions with regard to the recognition of SRT. It covers the following areas:

- Notification of securitisation transactions for which SRT is claimed or for which originator institutions apply for the recognition of SRT.
- ECB assessment of applications for approval of SRT under Articles 243(4) or 244(4) of the CRR.
- Ongoing monitoring of SRT.

The ECB recommends that relevant entities follow the guidance with respect to all securitisation transactions issued after its publication.

## Implicit support for SRT

Article 248 of the CRR lays down restrictions on sponsor institutions and originator institutions providing support to securitisations beyond their contractual obligations. Specifically, it provides that a sponsor or originator that transfers credit risk to reduce its risk-weighted exposure to the effect that it is no longer required to hold own funds in relation to that risk shall not, with a view to reducing potential or actual losses to investors, provide support to the securitisation beyond its contractual obligations.

A transaction shall not be considered to provide support (such as a repurchase of positions) if it is executed at arm's length conditions and taken into account in the assessment of significant risk transfer.

When assessing whether or not a transaction is structured to provide support, the institution must consider:

- The price of any repurchase.
- The institution's capital and liquidity position before and after repurchase.
- The performance of the securitised exposures.
- The performance of the securitisation positions.
- The impact of support on the losses expected to be incurred by the originator relative to investors.

If originator or sponsor institutions fail to comply with the relevant requirements, they shall, at a minimum, hold own funds against all of the securitised exposures as if such exposures had not been securitised.

On 20 January 2016, the EBA launched a consultation on draft guidelines on implicit support for securitisation transactions ([Legal update, EBA consults on draft guidelines on implicit support for securitisation transactions under CRR](#)) and on 3 October 2016, the EBA published a final report together with the final guidelines. The guidelines provide an objective test for the definition of arm's length conditions and for assessing when a transaction is not structured to provide support. Furthermore, guidance is provided on those elements that should be considered when assessing whether a transaction is not structured to provide support and on the notification requirements applicable to such transactions. Finally, the guidelines include provisions to avoid a scenario whereby support is provided on behalf of the originator by another entity.

The guidelines were finalised (with amendments) in October 2016 and will apply from 1 March 2017 ([Legal update, EBA final guidelines on implicit support for securitisation transactions under CRR](#)).

## MBS GUIDELINES AND PRINCIPLES

Transactional lawyers and their clients should also be aware of voluntary guidelines published by influential trade associations. Invariably, such guidelines are issued with a view to assisting market participants comply with applicable legal and regulatory frameworks. The following guidelines and principles, for example, have been widely adopted by the [mortgage-backed securities](#) (MBS) markets:

### RMBS markets

The European Securitisation Forum (now part of the Association for Financial Markets in Europe) issued best practice principles for [Residential mortgage-backed securities](#) (RMBS) transactions in February 2009.

The principles, known as "RMBS Issuer Principles for Transparency and Disclosure", relate to information to be disclosed by issuers of RMBS to investors and other market participants, both pre-issuance (such as marketing materials, prospectuses and other offering documents) and post-issuance (such as ongoing investor reports) and:

- Cover all RMBS secured by prime and non-conforming mortgage loans originated by issuers based in the [European Economic Area](#).
- Cover all RMBS structures, whether stand-alone or revolving structures (including master trusts).
- Will be reviewed on a regular basis to ensure they reflect changes in the market.

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- Build on existing legal frameworks for disclosure and transparency (such as the [Prospectus Directive](#), the [Market Abuse Regulation](#) and the [Transparency Directive](#)), although if there is a conflict between the principles and these legal framework, the latter will have to be complied with.

Compliance with the principles is voluntary. For further details, see [Legal update, European Securitisation Forum publishes RMBS issuer principles for transparency and disclosure](#).

For information on RMBS and master trusts, see [Practice note, Types of securitisation: Real estate-backed assets](#) and [Master Trusts](#).

## CMBS markets

The Commercial Real Estate Finance Council (Europe) issued best practice principles for [Commercial mortgage-backed securities](#) (CMBS) transactions in November 2012. The principles, known as "Market Principles for Issuing European CMBS 2.0", cover key areas including:

- Disclosure requirements for both pre and post issuance information, investor reporting and investor notices and valuations and property inspections.
- Revenue extraction.
- CMBS structural features such as controlling party rights, voting provisions, liquidity facilities and synthetic securitisations.
- The role of servicers, special services and other transaction counterparties such as trustees and cash managers.

Compliance with the principles is voluntary. For further details, see [Legal update, CREFC publishes market principles for CMBS transactions](#).

For information on CMBS and various securitisation transaction parties, see [Practice notes, Types of securitisation: Real estate-backed assets](#) and [Securitisation: overview: Participants, their roles and concerns](#), respectively.

## REFORMING THE INDUSTRY

Securitisation is an essential liquidity-generating tool and crucial to the growth and stability of financial markets and national economies. While securitisation has commonly been identified as one of the main factors contributing to the 2008-2009 financial crisis given the significant interconnection and correlation within the industry, the importance of securitisation in generating liquidity means that the revival of the securitisation markets is considered a crucial step to economic recovery.

Calls for an overhaul of the laws, regulations and agencies governing securitisation markets have led to a global effort to regulate the sector. By way of an example, at the request of the Financial Stability Board, the Technical Committee of the

International Organization of Securities Commissions (IOSCO) published a consultation report on global developments in securitisation regulation in June 2012 ([Legal update, IOSCO consults on global developments in securitisation regulation](#)). In November 2012, it published an additional "final" report on global developments in securitisation regulation ([Legal update, IOSCO policy recommendations for reform of securitisation markets](#)). However, by mid 2014, IOSCO (and others) appeared to see securitisation in a softer light, acknowledging the importance of securitisation to the strength of the global economy see [The future of \(simple and transparent\) securitisation](#)).

In addition to securitisation-specific regulation relating to origination, distribution, credit ratings, transparency and disclosure, the industry will also have to comply with broader reforms (such as those relating to regulatory capital and liquidity ratios) aimed at the banking sector generally (see [Practice notes, BCBS standards and guidelines: Securitisation in the Basel framework](#) and [Basel III: an overview](#)).

Given the current regulatory environment, European issuance of ABS and MBS has yet to show any significant recovery from post-crisis levels. In addition, banks can get cheaper funding by issuing retained securitisations and borrowing from central banks. For information on accessing central bank funding through the posting of eligible securitisation collateral, see [Practice note, Securitisation: eligible collateral for central bank operations](#).

Some market participants are concerned that blunt regulatory solutions should not be applied across the industry and that more care needs to be taken to ensure regulations are specifically targeted where they will be most effective.

## BRANCHES OF REFORM

This part of the note provides a brief description of the principal regulatory proposals (whether originating out of the EU, the US or the UK) impacting the UK securitisation markets. The scope of this part is limited to only those reforms that are likely to be of most interest to transactional lawyers. For links to additional and more detailed regulatory resources, see [Further reading: a wider regulatory perspective](#).

### THE FUTURE OF (SIMPLE AND TRANSPARENT) SECURITISATION

Regulators have recently begun to acknowledge the potential benefits of securitisation. The European Commission, the EBA and the Bank of England (BoE) have all given their qualified support to securitisation and other forms of non-bank lending (while reiterating the need to regulate the riskier aspects of shadow banking; an issue currently being tackled by the Financial Stability Board, see [Shadow banking](#)). In [Green Paper: Long-Term Financing of the European Economy](#)



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published on 25 March 2013, the European Commission expressed its vision of the securitisation market as one which embraces "simple securitisation products based [on] clear and unleveraged structures, using well-selected, diversified and low-risk underlying assets".

In May 2014, the BoE and the ECB published a joint discussion paper. The paper examines the potential benefits of a well-functioning securitisation market, identifies the impediments that have been preventing securitisation's revival in Europe and considers possible measures that regulatory authorities could develop to resuscitate the market (*Legal update, BoE/ECB discussion paper on reviving the European securitisation market*).

In December 2014, the Basel Committee on Banking Supervision and the International Organisation of Securities Commissions conducted a joint consultation to review securitisation markets worldwide and in July 2015 they published a final report on "Criteria for Identifying Simple, Transparent and Comparable Securitisations".

The 14 criteria, in relation to each of the identified key categories of risk (see below) in the securitisation process, relate to:

## Asset risk

- Nature of the assets.
- Asset performance history.
- Payment status.
- Consistency of underwriting.
- Asset selection and transfer.
- Initial and ongoing data.

## Structural risk

- Redemption cash flows.
- Currency and interest rate asset and liability mismatches.
- Payment priorities and observability.
- Voting and enforcement rights.
- Documentation disclosure and legal review.
- Alignment of interests.

## Fiduciary/servicer risk

- Fiduciary and contractual responsibilities.
- Transparency to investor.

In a speech given on 2 November 2015, Stefan Ingves, BCBS Chairman, stated that incorporation of the final versions of the BCBS-IOSCO criteria into the securitisation capital framework (see *Basel securitisation framework*) was planned to be finalised in 2016.

For further details, see *Legal updates, BCBS-IOSCO task force reviews securitisation markets worldwide, BCBS and IOSCO consult on criteria for identifying simple, transparent and comparable securitisations* and

## *BCBS and IOSCO final criteria for identifying simple, transparent and comparable securitisations.*

In October 2014, the EBA published its discussion paper on "simple, standard and transparent securitisations". The EBA wanted to assess, from a prudential perspective, whether there was merit in providing a preferential or differential regulatory capital treatment to certain "qualifying" securitisation products. The EBA acknowledged that a "one-size-fits-all" regulatory approach to securitisations no longer appeared to be appropriate and that, instead, the approach should incorporate a distinction between qualifying securitisations and other securitisations (*Legal update, EBA consults on discussion paper on simple, standard and transparent securitisations*).

On 7 July 2015, the EBA published an opinion and report, addressed to the European Commission, being its advice to the European Commission on a European framework for qualifying securitisations. The opinion contains five recommendations for establishing such a framework including a need to:

- Conduct a review of the entire regulatory framework for securitisations and other investment products;
- Create a framework for qualifying securitisations;
- Establish criteria to define both qualifying term securitisations and qualifying **asset-backed commercial paper** (ABCP).

The report proposes a more risk-sensitive approach to capital regulation for long-term securitisation instruments, as well as for ABCP and illustrates how the capital charges set out in the recent revision of the Basel securitisation framework should be lowered to recognise the relatively lower risk of qualifying products, while at the same time maintaining restraints on regulatory capital (*Legal update, EBA opinion and report on the establishment of a European framework for qualifying securitisations*).

In February 2015, the European Commission published a consultation paper on an EU framework for simple, transparent and standardised securitisation. Its purpose is to gather information on the current functioning of the European securitisation market and on how the current EU legal framework can be improved. For details of this consultation (which forms part of a wider EC initiative on building a Capital Markets Union), see *Legal update, EU framework for simple, transparent and standardised securitisation*. In responding to this consultation, the Joint Committee of the three European Supervisory Authorities published a report in May 2015 detailing its findings and recommendations in relation to existing EU law on structured finance instruments. The report looks at current disclosure requirements and obligations relating to due diligence, supervisory reporting and retention rules. The report focuses on the linkages between the due diligence requirements which apply to investors and the disclosure requirements which apply to the issuer, originator and sponsor, in order to highlight whether:

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- Investors are effectively protected.
- The supervision framework is appropriate to support the redevelopment of the EU securitisation markets.

For more information, see [Legal update, Joint Committee report on securitisation](#).

Reflecting the industry's views, the response of the [Loan Market Association](#) (LMA) to the Commission's consultation points out that the proposals would have the effect of excluding actively managed (dynamic) [CLOs](#) (for more on which, see [Practice note, Collateralised debt obligations \(CDOs\): overview: Portfolio management: available options - Dynamic](#)) from qualifying as "simple, transparent and standardised" securitisations. This would risk creating a twin track approach to securitisations in which those that do not 'qualify' for preferential treatment under the new rules will be seen to be of lesser quality or higher risk. The reality, at least in so far as actively managed CLOs are concerned, is that they can be as robust (if not more so) than some 'qualifying' or 'high quality' securitisations.

It is still too early to measure the impact of post-crisis regulation and so it remains to be seen if the breadth and depth of ongoing reforms will serve to inject confidence in the securitisation market or hamper its recovery. However, there is a growing acknowledgment that robust, simple and high quality securitisations that are clearly defined and in conformity with all applicable disclosure requirements are beneficial to the economy and should be accorded appropriate regulatory support. It is hoped this will be translated into favourable prudential treatment of institutions' own funds requirements for credit risk for holding high quality securitisation positions (as to which, see [The Securitisation Regulation](#)).

## THE SECURITISATION REGULATION

On 30 September 2015, the European Commission (EC) published a legislative proposal for a regulation laying down common rules on securitisation and creating a European framework for simple, transparent and standardised (STS) securitisation (Securitisation Regulation). It also published a legislative proposal for a regulation amending the CRR which deletes certain articles and extensively revises the capital requirements for securitisations ([Legal update, Legislative proposal for an EU framework for simple, transparent and standardised securitisation](#)).

The development of a simple, transparent and standardised securitisation market constitutes a building block of the capital markets union (CMU) action plan adopted by the EC on 30 September 2015 and is a priority for the EC ([Legal update, European Commission action plan for capital markets union: finance aspects](#)).

For an overview of the CMU (including links to key sources in relation to CMU initiatives affecting securitisations), see [Practice note, Capital markets union \(CMU\): overview](#).

The proposed Securitisation Regulation is based on what has been put in place in the EU to address the risks in complex and risky securitisations but is intended to help differentiate simple, transparent and standardised products and apply a more risk-sensitive prudential framework.

The proposed Securitisation Regulation aims to:

- Re-start the markets so that STS securitisation can act as an effective funding channel.
- Allow the risks to be transferred to a wide range of institutional investors.
- Allow securitisation to act as a funding mechanism for both banks and non-banks.
- Protect investors by avoiding the re-introduction of "originate to distribute" models of securitisation.

The proposed Securitisation Regulation contains provisions relating to:

- All securitisations (including STS securitisations). These provisions set out uniform definitions and rules that will apply across financial sectors, with the aim of harmonising existing legal provisions on due diligence, risk retention and disclosure. These are currently contained in a number of EU legislative instruments and are often inconsistent: Part Five of the CRR (Articles 404 to 410) for EU regulated credit institutions and investment firms; Article 17 of the AIFMD (as supplemented by Section 5 of Chapter III of Commission Delegated Regulation (EU) No 231/2013) for EU regulated alternative investment fund managers and Article 135(2) of Solvency II (as supplemented by Articles 254-257 of Commission Delegated Regulation (EU) No 2015/35) for EU regulated insurance and reinsurance undertakings.
- STS securitisations. This part contains criteria for STS securitisation for all financial sectors, eligible asset classes and transaction structures as well as relevant market participants across sectors.
- The roles of competent authorities in supervising securitisations.
- Consequential amendments to UCITS IV Directive (2009/65/EC), the Solvency II Directive (2009/138/EC), the CRA Regulation (Regulation 1060/2009), the Alternative Investment Fund Managers Directive (2011/61/EU) (AIFMD) and EMIR (the Regulation on OTC derivative transactions, central counterparties and trade repositories) (Regulation 648/2012).

Key articles in the proposed Securitisation Regulation that apply to all securitisations include:

- **Article 3 (Due diligence requirements for institutional investors).** This article is intended to replace current sectoral legislation that relates to due diligence. The definition of "institutional investor" is set out in Article 2 and includes credit institutions, insurance and reinsurance undertakings, investment firms,

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alternative investment fund managers, institutions for occupational retirement provision, UCITS management companies and internally managed UCITS.

- **Article 4 (Risk retention).** This article includes a direct risk retention requirement on the originator, sponsor or the original lenders. Existing sector-specific risk retention requirements already apply, however, they are generally focused on investors (the so-called "indirect approach") and the originators, sponsors or original lenders are not directly subject to the requirements. The intention is that this will make it more straightforward for investors to check whether these entities have retained any risk. The article includes certain exceptions where the securitised exposures are exposures that are fully, unconditionally and irrevocably guaranteed by various entities such as central governments or central banks.
- **Article 5 (Transparency requirements for originators, sponsors and securitisation special purpose entities (SSPEs)).** The transparency requirements are also intended to replace those contained in existing legislation. They are designed to ensure that investors will have all the relevant information on securitisations. It covers all types of securitisations and applies across sectors.

In addition to the introduction of a uniform securitisation regulatory framework, the other objective of the proposed Securitisation Regulation is to provide clear requirements as to what constitutes an STS securitisation. The requirements that apply solely to STS securitisations are set out, currently, in Articles 6 to 14 which are in summary:

- **Article 6 (Use of the designation "simple, transparent and standardised securitisation").** This article provides that originators, sponsors and securitisation special purpose entities (SSPEs) can only use the designation STS (or a designation that refers directly or indirectly to these terms) where the securitisation meets the requirements set out in the proposed Securitisation Regulation and they have notified the European Securities and Markets Authority (ESMA). The originators, sponsors and SSPEs are required to jointly notify ESMA with the STS notification subsequently being published on ESMA's website (Article 14). The requirements are slightly different for STS term securitisations and STS asset backed commercial paper (ABCP).
- **Article 8 (Requirements relating to simplicity (for securitisations except ABCP securitisations)).** This article sets out the requirements relating to simplicity that need to be met. In particular these include the requirement that an STS securitisation must be a "true sale" securitisation where the ownership of the underlying exposures is transferred or effectively assigned to a securitisation special purpose vehicle. A synthetic securitisation will not qualify as an STS securitisation (this is subject to on-going discussions; see [Proposals for synthetic securitisations](#)). Other requirements include:
  - the seller to provide representations and warranties to the best of their knowledge about the status of the underlying exposures;
  - the underlying exposures transferred from the seller to the SSPE need to meet predetermined and clearly defined eligibility criteria that do not allow for active portfolio management of those exposures on a discretionary basis;
  - the securitisation is to be backed by a pool of underlying exposures that are homogenous in terms of asset type, are contractually binding and enforceable obligations with full recourse to debtors, with defined periodic payment streams relating to rental, principal, interest payments or related to any other right to receive income from assets warranting such payments; and
  - the underlying exposures may not include assets that are themselves securitisations.
- **Article 9 (Requirements relating to standardisation (for securitisations except ABCP securitisations)).** This article sets out the requirements of standardisation that need to be met. Key requirements include:
  - mitigation of interest rate and currency risks that arise from the securitisation and disclosure of the measures taken to do this;
  - any referenced interest payments under the securitisation assets and liabilities to be based on generally used market interest rates and not reference complex formulae or derivatives; and
  - clear provisions in the transaction documents that facilitate timely resolution of conflicts between different classes of investors, clear allocation of voting rights and identification of responsibilities of any entity with fiduciary duties to investors.
- **Article 10 (Requirements relating to transparency (for securitisations except ABCP securitisations)).** This article sets out the transparency requirements that need to be met. They include an obligation on the originator or sponsor to provide a liability cash flow model to investors before pricing of the securitisation and on an on-going basis.
- **Articles 11, 12 and 13 (Requirements for ABCP securitisation).** The requirements for STS ABCP securitisations are contained in articles 11, 12 and 13 and include transaction level requirements (Article 12) and programme level requirements (Article 13) (which require the programme and all transactions in the programme to be eligible). The requirements are similar to those for term securitisations.
- **Article 14 (STS notification and due diligence).** This article sets out the responsibilities of originators, sponsors and SSPEs for notifying ESMA that a securitisation complies with the STS requirements. ESMA will publish the STS notification on its website. The EC states in its explanation that, although investors will still need to perform due diligence, they may place

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appropriate reliance on the STS notification and the information disclosed by the originator, sponsor and SSPE on STS compliance.

Other provisions in the proposed Securitisation Regulation include:

- **Articles 15 to 22 (Supervision).** Member states must designate competent authorities responsible for various aspects of the Securitisation Regulation, including the supervision of securitisation markets. Competent authorities should have the supervisory, investigatory and sanctioning powers that are normally available under EU financial services legislation. These articles also specify the roles to be played by the three European Supervisory Authorities (ESAs) in co-ordinating the work of competent authorities concerning STS securitisations.
- **Articles 23 to 27 (Amendments to other legislation).** These articles make consequential amendments to the UCITS IV Directive, the Solvency II Directive, the CRA Regulation, AIFMD and EMIR reflecting the creation of a harmonised securitisation framework by the Securitisation Regulation.

Between 10 November and 1 December 2015, the Presidency of the Council of the EU published three compromise proposals (13834/15, 14493/15 and 14537/15) relating to the proposed Securitisation Regulation and to the related CRR Amendment Regulation (for more on which, see [Legal updates, Council of the EU compromise proposal on the proposed Securitisation Regulation dated 9 November 2015](#), [Council of the EU second compromise proposals on proposed Securitisation](#) and [CRR Amendment Regulations and Council of the EU third compromise proposals on proposed Securitisation and CRR Amendment Regulations](#)).

On 8 December 2016, the European Parliament voted to adopt its compromised version of the Securitisation Regulation and the CRR Amendment Regulation, which will serve as the basis for the negotiation between the European Parliament and the Council of the EU which is expected to commence early 2017. The European Parliament's compromise version proposes to increase risk retention to 10% with the exception for the retention method of "first loss (tranche)" which is maintained at 5% and "first loss (exposure)" which is set at 7.5%.

Once finalised, the Securitisation Regulation will enter into force and apply on the twentieth day following its publication in the Official Journal of the EU (currently, Article 31). It will apply to all securitisations the securities of which are issued on or after the date on which the Regulation enters into force, subject to certain exceptions set out in what is currently Article 28.

## CRR Amendment Regulation

The purpose of the CRR Amendment Regulation is to revise the EU regime relating to capital changes for credit institutions and investment firms originating, sponsoring or investing in securitisation instruments, to provide for a more risk-sensitive regulatory treatment for STS securitisations.

The EC's proposals in the CRR Amendment Regulation reflect:

- A revised securitisation framework first issued by the Basel Committee on Banking Supervision (BCBS) in December 2014 which has since been updated (see [Legal update, BCBS issues revisions to Basel securitisation framework](#) and [Basel securitisation framework](#), below).
- A report published by the EBA in July 2015 on the establishment of a European framework for qualifying securitisations (Legal update, EBA opinion and report on the establishment of a European framework for qualifying securitisations). The EBA recommended that capital charges for STS securitisations should be lowered to a prudent level relative to those set out in BCBS303.

The proposed CRR Amendment Regulation will, among other things:

- Replace Chapter 5 Title II of Part Three of the CRR (Capital requirements for credit risk: securitisation) (that is, Articles 242 to 270) with new provisions:
  - implementing the regulatory capital calculation approaches set out in BCBS303 (at revised Articles 254 to 268 of the CRR); and
  - introducing a recalibration for STS securitisations, as proposed by the EBA in July 2015 (at revised Articles 243, 260, 262 and 264 of the CRR).
- Delete Part Five of the CRR (Exposures to transferred credit risk), to reflect the harmonised requirements for originators, sponsors and investors set out in the Securitisation Regulation, with the exception of Article 407 (additional risk weight) which will be transferred to a proposed new Article 270bis.

The proposed CRR Amendment Regulation does not specify when the CRR Amendment Regulation will become applicable.

## Proposals for synthetic securitisations

In December 2015, the EBA published a report which sets out the findings of its analysis and market practice assessment of the synthetic securitisation market ([Legal update, EBA report on synthetic securitisation](#)).

In relation to synthetic structures benefitting from financial guarantees from public bodies or **credit default swaps** provided by private investors that are fully cash collateralised, the report supports the extension of STS capital requirements on retained positions of senior synthetic tranches of small and medium-sized enterprise (SME) portfolios. The EBA states that the criteria determining the eligibility of certain synthetic securitisation positions for "qualifying" regulatory treatment should maintain a high degree of consistency with the criteria proposed in July 2015 to determine eligibility of traditional securitisations for "qualifying" regulatory treatment (see [Legal update, EBA opinion and report on the establishment of a European framework for qualifying securitisations](#) and [CRR Amendment Regulation](#), above) and advises on certain criteria for a "qualifying" treatment of synthetic securitisation.



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The EBA advises the European Commission to consider a modification of its securitisation proposals to extend eligibility to fully cash-funded credit protection provided by private investors in the form of cash deposited with the originator institution provided that specific criteria are fulfilled.

For more information about synthetic securitisations, see [Practice notes Types of securitisation: Synthetic structures](#) and [Structured finance: overview: Synthetic securitisation](#).

## BASEL SECURITISATION FRAMEWORK

The Basel Committee on Banking Supervision (BCBS) published in December 2014 its final standard on revisions to the Basel securitisation framework ([Legal update, BCBS issues revisions to Basel securitisation framework](#)). In the standard, the BCBS sets out text replacing the Basel II securitisation framework and the Basel 2.5 reforms relating to securitisation. The BCBS refers to this text as the Basel III securitisation framework. The new framework will come into effect in January 2018.

The final requirements set out in the standard incorporate feedback to two rounds of consultation in 2012 and 2013 ([Legal updates, BCBS consults on revisions to the Basel securitisation framework](#) and [BCBS second consultation on revisions to the Basel securitisation framework](#)). The revisions to the capital framework aim to address a number of perceived shortcomings in the existing securitisation framework and strengthen the capital standards for securitisation exposures held in the banking book. The specific objectives targeted by the revisions to the framework are to:

- Reduce mechanistic reliance on external ratings.
- Increase risk weights for highly-rated securitisation exposures.
- Reduce risk weights for low-rated senior securitisation exposures.
- Reduce cliff effects.
- Enhance the framework's risk sensitivity.

The initial consultation on the revised securitisation framework was launched in December 2012, the responses to which helped inform the BCBS in revising its original proposals; the BCBS subsequently published a second consultation in 2013. The main changes being consulted on in the second consultation relate to:

- New hierarchy of approaches in the securitisation framework. It is being proposed to replace the Modified Supervisory Formula Approach with the Internal Ratings-Based Approach (IRBA). This means the IRBA will sit at the top of the hierarchy of approaches.
- Applying a 15% risk-weight floor for securitisation exposures under all approaches. This is a reduction from the 20% risk weight floor that had originally been proposed in the initial consultation.

On 10 November 2015, the BCBS issued a further consultation paper on the capital treatment for simple, transparent and comparable securitisations (STC) ([Legal update, BCBS consults on capital treatment for simple, transparent and comparable securitisations](#)). The proposal builds on the revised capital standards issued by the BCBS in December 2014 and the publication of the STS criteria in July 2015 (see [The future of \(simple and transparent\) securitisation](#)). The consultation paper explains the rationale for incorporating the STC criteria into the revised securitisation framework and proposed options for doing so.

Subsequently, in July 2016, the BCBS issued an updated final standard on revisions to the Basel III securitisation framework ([Legal update, BCBS revisions to Basel III securitisation framework: July 2016](#)). The standard includes the regulatory capital treatment for STC securitisations and amends the BCBS' capital standards for securitisations that were published in December 2014. The standard sets out additional criteria for differentiating the capital treatment of STC securitisations from that of other securitisation transactions. The additional criteria, for example, exclude transactions in which the standardised risk weights for the underlying assets exceed certain levels. An accompanying press release states that compared to the consultative version, the final standard has scaled down the risk weights for STC securitisation exposures, and has reduced the risk weight floor for senior exposures from 15% to 10%. The BCBS issued a press release on 11 July 2016 which stated that it was reviewing similar issues related to short-term STC securitisations and that it expected to consult on criteria and the regulatory capital treatment of such exposures around the end of 2016. However, to our knowledge, no such consultation has been published.

Other Basel III reforms affecting the wider credit markets as well as securitisations (but which are beyond the scope of this note) include new rules on:

- Liquidity coverage and net stable funding ratios (see [Practice notes, Basel III: overview: Liquidity requirements](#) and [CRD IV: Capital Requirements Regulation \(CRR\): Liquidity requirements](#), and [Legal update, EBA consults on draft guidelines on liquidity coverage ratio disclosure](#)).
- Leverage ratio (see [Practice notes, Basel III: overview: Leverage ratio](#) and [CRD IV: Capital Requirements Regulation \(CRR\): Leverage ratio](#), and [Legal updates, BCBS issues final text of Basel III leverage ratio framework and disclosure requirements](#) and [BCBS finalises leverage ratio and LCR disclosure requirements and consults on NSFR](#)).

For more information on the BCBS' ongoing work relating to securitisation in the Basel framework, see [Practice note, BCBS standards and guidelines: Basel III securitisation framework](#).

For an outline of the full package of reforms proposed by Basel III, see [Practice note, Basel III: overview](#) and [Article, Basel III Framework: US-EU Comparison](#).

## IOSCO disclosure principles

In April 2010, IOSCO published its final report on disclosure principles for public offerings and listings of ABS. The report lists 19 categories of information which should be included in any offer document relating to a public offer or listing of ABS. The report's principles also apply to the preparation of disclosure documents in relation to re-sales of ABS to the public by either financial intermediaries or initial purchasers under a private placement. See [Legal update, IOSCO disclosure principles for asset-backed securities](#) for further details.

This was followed, in November 2012, by a further IOSCO report on 11 principles for ongoing disclosure for ABS ([Legal update, IOSCO final report on principles for ongoing disclosure for asset-backed securities](#)). Like the April 2010 principles which they complement, the ongoing disclosure principles:

- Are only intended to offer guidance to national securities regulators.
- Apply only to securities which are serviced by cash flows from a discrete pool of financial assets that ultimately convert into cash within a finite period of time, such as RMBS and CMBS. They do not cover CDO or CLO securities or covered bonds.

The ongoing disclosure principles encompass both periodic disclosures covering a specific time period, as well as event-based or ad hoc disclosures that are not time-specific (for example, those that are covered by price sensitive information requirements or by a pre-defined list of events). The 11 disclosure principles were unchanged from those set out in the consultation report on ongoing disclosure principles published in February 2012 ([Legal update, IOSCO consults on principles for ongoing disclosure for asset backed securities](#)).

The principles provide that ongoing disclosure reports should not be misleading or deceptive and should not contain material omissions. The party making the disclosure (the issuer of the ABS securities) will, depending on the disclosure regime of the relevant regulator, be required to provide investors with information either directly (for example, in the offering document or prospectus of a private offering) or indirectly (by filing reports with regulators or stock exchanges, in the case of a public transaction).

## Shadow banking

In April 2011, the Financial Stability Board (FSB) described the shadow banking system broadly as "credit intermediation involving entities and activities outside the regular banking system". This followed a request by the G20, in November 2010, for the FSB to provide recommendations on strengthening the oversight and regulation of shadow banking. Examples of vehicles used for shadow banking include structured investment vehicles (SIVs), asset-backed commercial paper (ABCP) conduits, money-market funds, certain securitisation

structures and hedge funds. The FSB in August 2013 published a policy framework for strengthening oversight and regulation of shadow banking entities.

The FSB, as well as the European Commission, IOSCO and the BCBS, are continuing to assess the shadow banking sector and these workflows may result in additional regulatory reforms affecting securitisations.

It should be noted, however, that many of the concerns relating to securitisation as a form of shadow banking have already been addressed by other regulatory initiatives. These concerns call for the alignment of interests between sponsors, originators and investors (addressed by risk retention requirements) and discouraging investment in multi-layered structures (addressed by rules on capital charges for re-securitisations and the BCBS securitisation framework proposals).

For further information, see Practice notes:

- [Shadow banking: an overview.](#)
- [Hot topics: European Commission Communication on shadow banking.](#)
- [BCBS standards and guidelines: Shadow banking.](#)

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## FATCA

The US Foreign Account Tax Compliance Act (FATCA), enacted in 2010, imposes a system of information reporting, requiring foreign (non-US) financial institutions (FFIs) and certain non-financial foreign entities (NFFEs) to disclose the identity of their US account holders and provide certain information on those accounts. FATCA also imposes a 30% withholding tax on withholdable payments made by US persons and others to FFIs and NFFEs that do not meet the information reporting requirements.

## Withholding and disclosure

Withholdable payments potentially subject to the 30% FATCA withholding tax include, but are not limited to, US-source interest, dividends and the gross proceeds from the sale of any property of a type that can produce US-source interest or dividends (such as payments arising under US portfolio assets). FATCA withholding generally applies to:

- Payments of US-source dividends, interest, rents, royalties and compensation made on or after 1 July 2014 to a FATCA non-compliant FFI or NFFE (other than certain payments made before 2017 on offshore obligations).
- Payments of gross proceeds from the sale or other disposition of any property of a type that can produce US-source interest or dividends made on or after 1 January 2019 to a FATCA non-compliant FFI or NFFE.

FATCA affects foreign payees, including foreign banks, securities dealers, investment funds, securitisation vehicles (including CDO and CLO

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issuers) and private investment vehicles that receive payments from US payers (such as US CDO and CLO noteholders). Therefore, FATCA will be of interest to UK structured finance lawyers advising on transactions involving each of:

- Non-US issuers.
- US portfolio assets.
- US noteholders.

Withholdable payments to a FFI are not subject to the FATCA withholding tax if the FFI has entered into a FATCA reporting agreement with the US Internal Revenue Service (IRS) to report detailed information about its US accounts. Alternatively, a UK FFI can meet its FATCA obligations, without having to enter into an agreement with the IRS, by reporting relevant information to [HMRC](#) and relying on the intergovernmental agreement (IGA) between the UK and the US. Compliant FFIs covered by a Model I IGA (see [UK/US IGA](#)) are treated as meeting the FATCA due diligence and reporting requirements, and are not subject to FATCA withholding. For information on FATCA withholding (including grandfathered obligations), see [Practice note, FATCA Withholding](#).

Note, however, that UK FFIs (regardless of the UK government's signing of the Model I IGA) are generally still required to register with the IRS as 'deemed-compliant FFIs' in order to avoid FATCA withholding.

For information on FFIs and NFFEs and their treatment under FATCA, see [Practice note, FATCA: FFIs and NFFEs](#).

## FATCA and CLOs

Limited relief is provided for certain vehicles issuing CLOs and whose documents do not contemplate FATCA (and would therefore lack the requisite corporate authority to comply with FATCA's registration, due diligence and reporting requirements; officially termed "limited-life debt investment entities" or "LLDIEs").

To qualify as a LLDIE and be treated as a certified deemed-compliant FFI, the CLO vehicle must:

- The FFI is an investment entity that issued one or more classes of debt or equity interests to investors pursuant to a trust indenture or similar agreement and all of such interests were issued on or before January 17, 2013.
- The FFI was in existence as of January 17, 2013, and has entered into a trust indenture or similar agreement that requires the FFI to pay to investors holding substantially all of the interests in the FFI, no later than a set date or period following the maturity of the last asset held by the FFI, all amounts that such investors are entitled to receive from the FFI.
- The FFI was formed and operated for the purpose of purchasing or acquiring specific types of debt instruments or interests therein and holding those

assets subject to reinvestment only under prescribed circumstances to maturity.

- Substantially all of the assets of the FFI consist of debt instruments or interests therein.
- All payments made to the investors of the FFI (other than holders of a de minimis interest) are either cleared through certain clearing organisations, custodial institutions and transfer agents (that are generally subject to U.S. reporting).
- The FFI's trustee or fiduciary is not authorized through a fiduciary duty or otherwise to fulfil the obligations under FATCA and no other person has the authority to fulfil the obligations on behalf of the FFI.

The CLO must also provide the payor a W-8BEN-E certificate in which it certifies that it meets the above requirements.

## UK/US IGA

On 12 September 2012, the governments of the United Kingdom and the United States signed a Model I IGA to improve international tax compliance and implement FATCA. The Model I IGA sets out a framework for information exchange, which ensures compliant UK financial institutions will be treated as deemed-compliant FFIs under FATCA and will not be required to withhold tax on withholdable payments they make or have FATCA withholding tax imposed on income they receive ([Legal update, UK and US sign agreement to implement FATCA](#)).

## UK's implementation regulations

The International Tax Compliance (United States of America) Regulations 2013 (*SI 2013/1962*) were made on 6 August 2013 (2013 regulations) to implement the UK/US Model I IGA and came into force on 1 September 2013 ([Legal update, UK FATCA implementing regulations made](#)). Since the 2013 regulations were made, the US has entered into FATCA agreements with other countries on more favourable terms than the Model I IGA with the UK, triggering that agreement's "most favoured nation" provision. Accordingly, a revised set of regulations, the International Tax Compliance (United States of America) Regulations 2014 (*SI 2014/1506*), were made on 9 June 2014 (2014 regulations) and replaced the 2013 regulations. The 2014 regulations were in force from 30 June 2014 to 14 April 2015 and were designed to reflect, from a UK perspective, the revised timelines and "most favoured nation" changes. The 2014 regulations have since been revised and replaced by the International Tax Compliance Regulations 2015 (*SI 2015/878*) (Compliance Regulations) which came into force on 15 April 2015 (as amended by The International Tax Compliance (Amendment) Regulations 2015 (*SI 2015/1839*) and, from 17 May 2017, The International Tax Compliance (Amendment) Regulations 2017 (*SI 2017/598*)).

The Compliance Regulations seek to unify the reporting requirements in relation to the UK's other information exchange agreements (Automatic Exchange of Financial

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Account Information in Tax Matters commonly referred to as the "Common Reporting Standard" or "CRS", the UK's agreements with Crown Dependencies and Overseas Territories commonly referred to as "CDOT agreements", and the EU Council Directive 2014/107/EU of 9 December 2014 on mandatory automatic exchange of information in the field of taxation commonly referred to as the "directive on administrative co-operation" or "DAC").

For more information, see [Practice note, CRS, EU administrative co-operation and FATCA: UK implementing regulations](#) and Legal updates:

- [HMRC consults on implementation of UK-US FATCA agreement.](#)
- [Implementing the UK-US FATCA agreement: revised draft regulations and guidance.](#)
- [HMRC publishes revised FATCA implementing regulations guidance.](#)
- [FATCA: replacement UK implementing regulations made.](#)

## Further resources on FATCA

For further information on the impact of FATCA on CLOs, see [Practice note, Collateralised loan obligations: tax: Other taxes](#) and [Article, Impact of FATCA on Foreign Funds: CLOs.](#)

For a guide to Practical Law's principal resources on FATCA, see [Practice note, A guide to Practical Law's FATCA resources.](#)

## Further reading: a wider regulatory perspective

For a broader and more detailed insight into the EU and UK regulatory landscape and to keep track of reforms affecting finance transactions and the wider financial markets, visit:

- The [Practical Law Financial Services homepage](#) and, specifically, its [Securities, Markets and Investments](#) and [Prudential Regulation](#) topic pages.

For information on tax issues relating to securitisations, see [Practice note, Securitisation: tax.](#)

For information on our structured finance and regulatory resources, see Practice notes:

- [Accessing Practical Law Finance's structured finance resources.](#)
- [Accessing Practical Law Finance's regulatory resources.](#)

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