

New EU Securitisation Regulations to Alter Securitisation Markets

New rules will modify regulatory capital requirements for securitisation positions and unify risk retention practices.

By year end, the European Commission (the EC) is expected to publish two new EU regulations in the Official Journal of the European Union that will enter into force on the twentieth day following publication. The first regulation (the Securitisation Regulation) will set out substantive criteria for simple, transparent, and standardized securitisations and will unify the criteria for risk retention, due diligence, and disclosure. The second regulation (the CRR Amendment Regulation and, together with the Securitisation Regulation, the Securitisation Regulations) will amend 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 (as amended by the CRR Amendment Regulation, the Capital Requirements Regulation or the CRR).¹ The date of application of both regulations is set to be January 1, 2019.

This *Client Alert* is based on the text of the two regulations as issued by the Council of the European Union (the Council) in June 2017, which Latham understands has been agreed by the Council, the EC, and the European Parliament (the EP). The definitive text of the Securitisation Regulations will only be known once the two regulations are published in the Official Journal.

When effective, the Securitisation Regulations will change many of the rules governing securitisation transactions, including:

- Requiring new regulatory capital calculation methodologies for securitisation positions, thereby correcting shortcomings of the existing regulatory capital framework that the CRR Amendment Regulation modifies; namely, mechanistic reliance on external ratings; excessively low risk weights for highly-rated securitisation tranches; conversely, excessively high risk weights for low-rated tranches; and insufficient risk sensitivity
- For the first time, setting out the substantive criteria for an overarching securitisation framework for simple, transparent, and standardised (STS) securitisations
- Setting out a set of common requirements regarding risk retention, due diligence, and disclosure for investors in all financial services sectors regulated within the EU — e.g., banks, investment firms, insurance and reinsurance undertakings, pension funds, alternative investment funds, and collective investment undertakings (collectively, institutional investors)

This *Client Alert* describes the new requirements introduced by the Securitisation Regulations in these three key areas and summarises certain other changes.²

Revised Regulatory Capital Requirements for Securitisation Positions

Regulators have for some years expressed scepticism about institutions' ability accurately to determine regulatory capital levels for securitisation positions, both because securitisations give rise to so-called agency risks, which are not entirely resolved by the risk retention rules, and because regulators do not believe that risk models adequately capture all risk drivers (such as asset correlation). As a result, the CRR Amendment Regulation sets out new methods for calculating capital requirements for securitisation positions, increases the regulatory capital floor on securitisation positions to 15% (or 10% in the case of STS securitisation positions), and severely limits re-securitisation transactions (*i.e.*, securitisations of securitisation positions). The new calculation methods are widely expected to result in higher capital charges for securitisation positions relative to the capital levels currently required.

To temper the impact of the new rules in part, the CRR Amendment Regulation provides that:

- Subject to certain conditions, an institution may assign senior securitisation positions a maximum risk weight equal to the exposure-weighted average risk weight applicable to the underlying exposures in the securitisation, irrespective of the calculation methodology used.
- As provided in the existing rules, for each institution that can calculate the capital requirements for all underlying exposures in a securitisation in accordance with the Internal Ratings-Based approach (IRB Approach) as if those exposures had not been securitised (K_{IRB}), such institution may apply such aggregate capital charge as the maximum capital charge for all securitisation positions it holds in such securitisation. As a result, an institution will not need to hold more capital if it securitises assets than if it continues to hold the assets on its balance sheet.

Hierarchy of Approaches

If an institution has permission to use the IRB Approach in relation to exposures of the same type as those underlying the securitisation, and is able to calculate K_{IRB} , in each case, subject to certain pre-defined inputs, an institution must use the securitisation IRB approach (the SEC-IRBA) to calculate risk weights for securitisation positions.

If an institution may not use the SEC-IRBA, a Securitisation Standardised Approach (the SEC-SA) is available in relation to given securitisation positions. The SEC-SA relies on a supervisory-provided formula using other inputs, including the capital requirements that would apply under the Standardised Approach to the underlying exposures as if the exposures had not been securitised (K_{SA}).

If neither SEC-IRBA nor SEC-SA is available, institutions must apply the Securitisation External Ratings-Based Approach (the SEC-ERBA), pursuant to which capital requirements are determined on the basis of the rating (explicit or inferred) of the securitisation position. As provided under existing rules, institutions may use the internal assessments approach (the IAA) to calculate risk-weighted exposure amounts in relation to an unrated position in an ABCP programme.³

Finally, as provided under the existing rules, if the risk weight of an unrated securitisation position cannot be determined under any of the methodologies mentioned above, the securitization position will have a risk weight of 1,250% (or alternatively can be deducted from Tier 1 capital at the election of the institution).

In addition, for rated positions (explicit or inferred), institutions must use the SEC-ERBA:

- Where applying the SEC-SA would result in a risk weight higher than 25% for STS securitisation positions
- Where applying the SEC-SA would result in a risk weight higher than 25% or where applying the SEC-ERBA would result in a risk weight higher than 75% for non-STs securitisation positions
- For securitisation transactions backed by pools of auto loans, auto leases, and equipment leases

Institutions may opt out of the SEC-SA and apply the SEC-ERBA to all rated securitisation positions by notifying the competent authority prior to the application date of the CRR Amendment Regulation. Any decision to opt out may subsequently be changed commencing in the following calendar year if, after notice of the proposed change is given to the competent authority, the competent authority does not object. Finally, competent authorities may prohibit the use of the SEC-SA when the SEC-SA does not capture the true risks of a securitisation position, whether those risks might affect the solvency of an institution or financial stability generally.

Internal Ratings Based Approach (SEC-IRBA)

The SEC-IRBA formula produces a risk weight for a securitisation position, which an institution or investment firm then uses to determine the required capital for the position. The higher the risk weight, the higher the capital charge.

The SEC-IRBA formula requires as its main inputs K_{IRB} , the attachment point (A) and the detachment point (D) of the securitisation position (*i.e.*, where the securitisation position ranks in seniority in the securitisation), and the maturity (either the weighted average of contractual payments or the final legal maturity) of the securitisation position (M_T). K_{IRB} must include both expected and unexpected losses, as well as dilution risks if material. M_T is subject to certain adjustments: a floor of one year and a cap of five years. Other inputs include the effective number of underlying exposures (N), the exposure-weighted average loss-given-default (LGD) of the pool of underlying exposures, and certain other inputs (A, B, C, D, and E) determined on the basis of the granularity of the pool and the seniority of the securitisation position.

Unless precluded by the competent authority, an institution may use SEC-IRBA if a pool of IRB exposures or a mixed pool of exposures backs the securitization position, and if there is sufficient information to calculate K_{IRB} . For example, competent authorities may exclude the use of SEC-IRBA for securitisations with complex or highly risky features (*e.g.*, transactions in which credit enhancement can be eroded for reasons other than credit losses, transactions with highly correlated underlying exposures, transactions where repayment is dependent on factors not reflected in K_{IRB} , or transactions involving highly complex loss allocations between tranches).

The SEC-IRBA formula, which is subject to a floor of 15% (or 10% in the case of an STS securitisation position), is as follows:

$$RW = \left[\left(\frac{K_{IRB} - A}{D - A} \right) \cdot 12.5 \right] + \left[\left(\frac{D - K_{IRB}}{D - A} \right) \cdot 12.5 \cdot K_{SSFA(K_{IRB})} \right]$$

Other inputs necessary to make the SEC-IRBA determinations are set out in the CRR Amendment Regulation.

Securitisation Standardised Approach (SEC-SA)

The relevant SEC-SA formula also produces a risk weight for a securitisation, and is subject to a floor of 15% (or 10% for STS securitisations). The SEC-SA formula is less risk-sensitive than the SEC-IRBA formula and, as a result, generally results in higher risk weights.

The key input (K_A) is determined by adjusting K_{SA} by the expected delinquencies in the underlying exposures. In the formula for K_A below, the variable W equals the ratio of the sum of the nominal amount of delinquent underlying exposures to the nominal amount of underlying exposures:

$$K_A = (1-W) \cdot K_{SA} + W \cdot 0.5$$

The relevant SEC-SA determinations are as follows:

- When $D \leq K_A$, the risk weight is 1,250%
- When $A \geq K_A$, the risk weight is $12.5 \times K_{SSFA(K_A)}$
- When $A < K_A < D$, the formula is as follows:

$$RW = \left[\left(\frac{K_A - A}{D - A} \right) \cdot 12.5 \right] + \left[\left(\frac{D - K_A}{D - A} \right) \cdot 12.5 \cdot K_{SSFA(K_A)} \right]$$

Other inputs necessary to make the SEC-SA determinations are set out in the CRR Amendment Regulation.

Securitisation External Ratings-Based Approach (SEC-ERBA)

Under the SEC-ERBA, the risk weight of a securitisation position is determined from its explicit or implied rating pursuant to the relevant table below. The four tables differ depending on whether the tranche has a short-term rating or a long-term rating, and whether or not the position qualifies as an STS securitisation position.

For short-term ratings, the risk weight table for STS securitisation positions is as follows:

Credit Quality Step	1	2	3	All other ratings
Risk Weight	15%	30%	60%	1,250%

For long-term ratings, the risk weight table for STS securitisation positions is as follows:

Credit Quality Step	Senior Tranche		Non-senior (thin) tranche	
	<i>Tranche maturity (M_T)</i>		<i>Tranche maturity (M_T)</i>	
	<i>1 year</i>	<i>5 years</i>	<i>1 year</i>	<i>5 years</i>
1	10%	10%	15%	40%
2	10%	15%	15%	55%

Credit Quality Step	Senior Tranche		Non-senior (thin) tranche	
	<i>Tranche maturity (M_T)</i>		<i>Tranche maturity (M_T)</i>	
	<i>1 year</i>	<i>5 years</i>	<i>1 year</i>	<i>5 years</i>
3	15%	20%	15%	70%
4	15%	25%	25%	80%
5	20%	30%	35%	95%
6	30%	40%	60%	135%
7	35%	40%	95%	170%
8	45%	55%	150%	225%
9	55%	65%	180%	255%
10	70%	85%	270%	345%
11	120%	135%	405%	500%
12	135%	155%	535%	655%
13	170%	195%	645%	740%
14	225%	250%	810%	855%
15	280%	305%	945%	945%
16	340%	380%	1,015%	1,015%
17	415%	455%	1,250%	1,250%
All other	1,250%	1,250%	1,250%	1,250%

For short-term ratings, the risk weight table for non-STS securitisation positions is as follows:

Credit Quality Step	1	2	3	All other ratings
Risk Weight	15%	50%	100%	1,250%

For long-term ratings, the risk weight table for non-STS securitisation positions is as follows:

Credit Quality Step	Senior Tranche	Non-senior (thin) tranche
	<i>Tranche maturity (M_T)</i>	<i>Tranche maturity (M_T)</i>

	<i>1 year</i>	<i>5 years</i>	<i>1 year</i>	<i>5 years</i>
1	15%	20%	15%	70%
2	15%	30%	15%	90%
3	25%	40%	30%	120%
4	30%	45%	40%	140%
5	40%	50%	60%	160%
6	50%	65%	80%	180%
7	60%	70%	120%	210%
8	75%	90%	170%	260%
9	90%	105%	220%	310%
10	120%	140%	330%	420%
11	140%	160%	470%	580%
12	160%	180%	620%	760%
13	200%	225%	750%	860%
14	250%	280%	900%	950%
15	310%	340%	1,050%	1,050%
16	380%	420%	1,130%	1,130%
17	460%	505%	1,250%	1,250%
All other	1,250%	1,250%	1,250%	1,250%

Risk weights for tranches with a long-term rating and a maturity of between 1 and 5 years are in each case to be determined by linear interpolation of the values set out in the table above relevant to that tranche.

Simple, Transparent, and Standardised Securitisations⁴

Justification for Lower Capital Charges

In concluding that lower regulatory capital charges and a lower 10% risk weight floor are appropriate for STS securitisation positions, the Securitisation Regulation:

- Acknowledges that securitisation transactions “are an important constituent part of well-functioning financial markets insofar as they contribute to diversifying institutions' funding and risk diversification

sources, and releasing regulatory capital which can then be reallocated to support further lending, in particular the funding of the real economy”

- Cites empirical evidence set out in the European Banking Authority (EBA)’s July 2015 publication “*Report on Qualifying Securitisations*” to conclude that “STS securitisations exhibited better performance than other securitisations during the financial crisis, reflecting the use of simple and transparent structures and robust execution practices in STS securitisation which deliver lower credit, operational and agency risks.” The Securitisation Regulation permits a more risk-sensitive approach for STS securitisations to be available for both qualifying traditional cash securitisations, in which ownership of the underlying exposures are transferred to securitisation special-purpose entities (SSPEs), and qualifying synthetic securitisations, in which institutions retain senior positions against specified pools of loans (typically, although not necessarily, held on the institutions’ balance sheets).

STS Requirements

The Securitisation Regulation permits a securitisation to be designated an STS securitisation if the securitisation meets the relevant conditions. After the originator or sponsor has notified the European Securities and Markets Authority (ESMA) of the transaction, the transaction will appear on the ESMA’s list (described below). The Securitisation Regulation permits a securitisation issued before the Securitisation Regulation’s application date to qualify as an STS securitisation provided that it met the specified requirements at the time of issuance.

The requirements for STS treatment are set out in three categories — those relating to simplicity, those relating to standardisation, and those relating to transparency.

Simplicity requirements:

- The originator, sponsor, and SSPE involved must be established in the EU.
- Titles to the underlying exposures must be transferred to the SSPE via a “true sale” transfer with no “severe clawback” in the event of the seller’s insolvency,⁵ and the seller must warrant that there are no known conditions that could impair the true sale transfer.
- The underlying exposures meet predetermined and clearly documented eligibility criteria that do not allow active discretionary portfolio management.
- The pool of underlying exposures is homogenous in terms of credit risk, cash flows, and asset type.
- The pool of underlying exposures contains obligations that are contractually binding and enforceable, are full recourse to debtors and other obligors, and that have defined periodic payment streams (and may not include any transferrable securities other than unlisted corporate bonds or securitisation position).
- Underlying exposures must be originated in the ordinary course of the originator’s or the original lender’s business, pursuant to underwriting standards (which must be disclosed to potential investors without undue delay) that are no less stringent than those that the originator or the original lender applied at the time of origination to similar exposures that are not securitised, and if applicable, must satisfy the Residential Loan Criteria (defined below).
- An assessment of the underlying debtor’s creditworthiness must meet specified statutory requirements, and the originator or original lender shall have expertise in originating exposures of a similar nature to those securitised.

- At the time of transfer to the SSPE, the risk weights of the underlying exposures must not exceed specified amounts depending on the asset type.
- The underlying exposures transferred to the SSPE cannot include exposures in default, or exposures to a debtor or other obligor that has undergone certain specified credit impairments, such as insolvency or a recent debt restructuring (subject to certain disclosed exceptions), or a credit score indicating that the risk of non-payment is significantly higher than the exposures retained by the originator or the original lender.
- The debtor shall have made at least one payment, other than single-installment debts or debts with a maturity of less than one year.
- Repayment of the securitisation positions shall not depend predominantly on the sale of assets. (Underlying exposures guaranteed or fully covered by a repurchase obligation are not considered dependent on asset sales.)

Standardisation requirements:

- The originator, sponsor, or original lender shall satisfy the risk-retention requirements.
- Interest rate and currency risks shall be mitigated in accordance with common documentation standards, and measures taken to mitigate shall be disclosed; otherwise, the SSPE shall not enter into derivatives and shall ensure that the underlying exposures does not include derivatives.
- Referenced interest payments shall be based on generally used market interest rates or sectoral rates, and shall not reference complex formulae or derivatives.
- Following an enforcement or acceleration notice, (i) no cash may be trapped other than that necessary to ensure the orderly functioning of the SSPE, the orderly payment of investors, or to avoid deterioration in the credit quality of the underlying exposures, (ii) principal receipts shall be distributed to investors sequentially by seniority (and not in any other order), and (iii) no provision shall require automatic liquidation of underlying exposures.
- Transactions featuring non-sequential payments shall contain triggers (e.g., deterioration of credit quality of underlying exposures) reverting to sequential distributions.
- Transaction documentation shall include (at least) all of the following triggers to terminate any revolving period: (i) deterioration of credit quality of underlying exposures, (ii) originator or service insolvency event, (iii) drop in underlying exposures' value below a pre-determined threshold, or (iv) failure to generate sufficient new underlying exposures that meet required credit quality.
- Transaction documentation shall clearly specify: (i) contractual obligations of trustee and other service providers, (ii) the processes to ensure continuity in servicing, and (iii) provisions to replace derivative counterparties, liquidity providers, and account banks.
- The servicer shall have experience in servicing assets of a similar nature to those securitised.
- The transaction documentation shall set out in clear and consistent terms, definitions, remedies, and actions relating to delinquency and default of debtors, debt restructuring, debt forgiveness, forbearance, payment holidays, losses, charge offs, recoveries, and other asset performance remedies.

- The transaction documentation shall clearly specify the priorities of payment, events which trigger changes in such priorities of payment, and an obligation to report such events (and any change in the priority of payments must be reported to investors without undue delay unless the change will not materially adversely affect the repayment of the securitisation position).
- The transaction documentation shall include clear provisions facilitating the timely resolution of conflicts between different classes of investors; voting rights shall be clearly defined and allocated to noteholders; and the responsibilities of the trustee and other entities with fiduciary duties to investors shall be clearly identified

Transparency requirements:

- Before pricing, the originator and the sponsor shall allow potential investors access to static and dynamic historical default and loss performance data, such as delinquency and default data, for exposures substantially similar to those being securitised, as well as the sources of that data and the basis for claiming similarity. The data must cover a period of at least five years.
- Before closing, a sample of the underlying exposures shall be subject to external verification by an appropriate and independent party. This party will verify that the data disclosed in respect of the underlying exposures is accurate.
- Before pricing, the originator or the sponsor shall make a liability cash flow model reflecting the precise contractual relationship between the underlying exposures and the payments flowing between the originator, sponsor, investors, other third parties, and the SSPE available to potential investors. After pricing, the originator or the sponsor shall make that model available to investors on an ongoing basis and upon request.

The Securitisation Regulation specifies that originators and sponsors must jointly notify ESMA should a securitisation meet the STS requirements. An STS notification must explain how each STS requirement is met. The originator, sponsor, or SSPE may use a third-party service authorised by the competent authority to check STS compliance. Originators and sponsors must disclose in the STS notification if they have used a service; however, using such a service does not affect the legal obligations of the originator, sponsor, or SSPE under the Securitisation Regulation. STS notifications delivered by originators or original lenders that are not covered by the CRR must be accompanied by confirmation that credit is granted in accordance with the Credit Granting Criteria (defined below).

The Securitisation Regulation requires ESMA to publish STS notifications on its website (as mentioned above). ESMA must also maintain a list of all securitisations for which it has received an STS notification. The list must be updated immediately upon receipt of an STS notice. ESMA must also notate the list immediately if any competent authority notifies ESMA that a securitisation is no longer considered to qualify as an STS securitisation, or if the authority has imposed administrative sanctions on such transaction under the Securitisation Regulation. The Securitisation Regulation permits institutional investors to rely on STS notifications and the list, but not solely or mechanically.

Risk Retention

The Securitisation Regulation applies uniform risk retention, due diligence, and reporting requirements to all institutional investors.

Obligations Imposed on Institutional Investors

As under existing rules, the Securitisation Regulation prohibits an institutional investor from becoming exposed to a securitisation position unless:

- The originator, original lender, or sponsor, regardless of whether it is located within or outside of the European Union (EU), retains on an ongoing basis a material net economic interest of not less than 5% in the securitisation and discloses the risk retention to investors.
- The originator, original lender, or sponsor, regardless of whether it is located within or outside of the EU, makes certain information about the securitisation available to investors.
- The institutional investor has carried out due diligence enabling it to assess the risk characteristics of the specific securitisation position and the underlying exposures, as well as all structural features of risks of the securitisation that could impact its performance materially, including the payment priority waterfalls, the triggers that may change payment priorities, credit and liquidity enhancements, market value triggers, and events of default.

Obligations Imposed on Originators, Original Lenders, and Sponsors

For the first time, the Securitisation Regulation requires the originator, original lender, or sponsor (or, absent agreement among them, the originator) to hold a material economic interest of not less than 5% in each securitisation transaction. Under the Securitisation Regulation, as under existing rules, (a) the required retention interest is measured at origination and is determined by the notional value for off-balance sheet items, (b) there are no multiple applications of the retention requirements for any given securitisation, and (c) the required retention interest may not be split among different types of retainers and may not be subject to any credit risk mitigation or hedging.

The Securitisation Regulation also requires all originators and original lenders, regardless of whether they are located within or outside of the EU, to grant all credits giving rise to exposures underlying a securitisation transaction “on the basis of sound and well-defined criteria and clearly established processes for approving, amending, renewing and financing those credits and has effective systems in place to apply those criteria and processes to ensure that credit-granting is based on a thorough assessment of the obligor’s creditworthiness” (the Credit Granting Criteria).

Originator Requirements

The Securitisation Regulation provides that an entity established or operating for the sole purpose of securitising exposures will not be considered an originator. On a practical level, this requirement means that originators must conduct a certain amount of other business that does not involve securitisations (but which may involve buying and holding investments in the same assets or types of assets that it securitises). Given that the EBA suggested such a requirement years ago, the securitisation markets have largely already adopted it into existing transaction structures.

The Securitisation Regulation also prohibits originators from transferring assets to an SSPE with the aim of rendering losses on those assets that exceed the losses over comparable assets retained by the originator, measured over the life of the transaction up to a maximum period of four years. The

Securitisation Regulation authorises sanctions against originators if the performance of transferred assets is, in fact, significantly lower than the performance of retained assets because of the originator's intention.

Sponsor Definition

The Securitisation Regulation defines "sponsor" by reference to MiFID II⁶ rather than the CRR in order to permit entities located outside the EU (but with the permission required under MiFID II) to qualify as sponsors for purposes of the Capital Requirements Regulation.

Information Requirements

The Securitisation Regulation requires originators, original lenders, and sponsors to make significant amounts of information and documentation relating to securitisations available to investors, including:

- Information on the underlying exposures on a monthly or quarterly basis
- All underlying documentation that is essential for understanding the securitisation, including the final offering document or prospectus, the closing documents excluding legal opinions, the asset sale agreement (or other transfer document), the derivatives or guarantee documents, the various servicing (primary, special, standby, etc.) agreements, the trust deed, the security deed, the agency agreement, the bank agreement, relevant intercreditor agreements, subordinated loan agreements, liquidity agreements and, if not otherwise included, the priority of payments waterfalls
- If a prospectus is not required, details regarding the transaction's structure, including a structure diagram, information on the exposure characteristics of the assets, cash flows, a loss waterfall, credit enhancement and liquidity features, details regarding the voting rights of investors and their relation to other secured creditors, and a list of all trigger events that could materially impact the performance of the securitisation position
- In the case of an STS securitisation, the notification required under the STS rules
- Monthly or quarterly investor reports, all materially relevant data on the credit quality and performance of the underlying assets, data on the cash flows generated by the underlying assets (other than for ABCP conduits) and information regarding the breach of any triggers that would result in changing the priority of payments or the replacement of counterparties, as well as risk-retention information
- Any material non-public information that the originator, sponsor, or SSPE is obliged to make public under the EU market abuse rules
- Material breaches of the documents, changes in structural features, changes in risk characteristics that can materially impair performance (e.g., in the case of an STS securitisation, if the transaction ceases to meet the STS requirements or competent authorities have taken remedial or administrative action), and material amendments to the transaction documents

The Securitisation Regulation specifies that the information described in paragraphs (b), (c), and (d) must be made available prior to pricing, and that the information in paragraphs (a) and (e) must be provided on an ongoing basis. The Securitisation Regulation specifies that the information in paragraphs (f) and (g) must be made available without delay. When complying with the information requirements, the originator, sponsor, and SSPE of a securitisation must continue to comply with all relevant national and EU law governing the protection of confidentiality of information and the processing of personal data (and in that regard must anonymise or aggregate data if necessary).

The information must be provided to a securitisation repository (an entity established in the EU registered with ESMA) or another entity, in each case satisfying certain conditions. The information held by securitisation repositories is available to various EU bodies (e.g., ESMA, EBA, the European Central Bank, and its members), member-state supervisors, resolution authorities, and investors and potential investors, among others.

Certain Terms Unchanged

Despite some initial disagreement between the EC, the Council, and the EP during the development of the Securitisation Regulation, the risk retention rules retain the 5% minimum retention amount, and do not (as the EP had requested) empower the EC to increase the required retention amount. Thus, only further legislative action may change the required retention amount. The five existing retention options (including vertical slice and horizontal first-loss slice) have not changed, nor have the methods of calculating the 5% minimum retention requirement (e.g., 5% of the nominal value of each of the tranches sold or transferred to investors in the case of a vertical slice, and 5% of the nominal value of the securitised exposures in the case of a horizontal slice).

Other Significant Changes and Issues

Grandfathering

The application date for each of the Securitisation Regulations is set to be January 1, 2019. The regulations will apply to securitisations issued on or after that date. Regarding securitisation positions issued prior to that date:

- The Securitisation Regulation provides that all affected EU credit institutions, investment firms, insurance undertakings, reinsurance undertakings, and alternative investment fund managers shall remain subject to the risk retention, due diligence, and disclosure rules in place on the day before the Securitisation Regulation application date.
- The CRR Amendment Regulation provides that an institution or investment firm that has notified the relevant national authority may apply the existing rules to determine regulatory capital charges until December 31, 2019, following which the new regulatory capital requirements will apply.

Resecuritisations

Subject to limited exceptions, the Securitisation Regulation prohibits resecuritisation transactions by providing that the underlying exposures in a securitisation may not include securitisation positions. The exceptions include:

- Any securitisation securities issued before the date of application of the Securitisation Regulation
- Any securitisation to be used for the legitimate purpose of facilitating the winding up of a credit institution, an investment firm, or a financial institution, ensuring such institution's viability as a going concern, or to avoid such institution's winding up
- Where the underlying exposures are non-performing, any securitisation to be used for the legitimate purpose of preserving the interests of investors

Under the Securitisation Regulation, a fully supported asset-backed commercial paper (ABCP) conduit is not considered a resecuritisation, provided that none of the transactions within the conduit is a

resecuritisation and the credit enhancement to the conduit does not establish a second layer of tranching at the conduit.

For existing resecuritisation transactions, the regulatory capital charge must be determined pursuant to SEC-SA, with a floor of 100%, and certain other adjusted inputs designed to increase the capital charge compared with securitisations in which none of the underlying exposures are securitisation positions.

Additional Criteria for Credit Granting

If the underlying exposures of a securitisation are residential loans, the Securitisation Regulation prohibits the pool of such loans from including any loan that is marketed and underwritten on the premise that the loan applicant (or, where applicable, any intermediary) was made aware that the information provided by the applicant might not be verified by the lender (the Residential Loan Criteria). If an originator purchases third-party exposures for its own account and then securitises them, the originator must verify that the original lender fulfils the requirement that the exposures have arisen under sound, well-defined credit criteria consistently applied.

Sales to Retail Investors

The Securitisation Regulation prohibits sales of securitisation positions to retail investors unless:

- The seller has conducted a suitability test confirming that the securitisation position is suitable for the client (and immediately communicates that outcome to the client in a report)
- If the retail investor's financial instrument portfolio does not exceed €50,000, the seller shall ensure (based upon information provided by the client) that securitisation positions do not constitute more than 10% of the client's financial instrument portfolio including cash deposits.

European Systemic Risk Board Oversight

The Securitisation Regulation tasks the European Systemic Risk Board (ESRB) with the macro-prudential oversight of the EU securitisation markets, and continuous monitoring developments in the securitisation markets generally. In order to highlight financial stability risks, the ESRB must, where it considers necessary and at least every three years, publish a report with the EBA on the financial stability implications of the securitisation market. If the ESRB observes material risks, they shall issue recommendations for remedial action in response to these risks to the EC, the three European Supervisory Authorities⁷ (the ESAs), and the Member States.

Sanctions

Member States must adopt appropriate administrative sanctions (or, in the case of negligent or intentional infringement, remedial measures) for infringements of the Securitisation Regulation, including (without limitation) failing to satisfy risk retention requirements or making a misleading STS notification. The Securitisation Regulation requires adoption of at least the following measures:

- Public notification of the identity of the infringer and the nature of the infringement.
- An order requiring the infringer to cease and desist the infringing conduct.
- A ban on members of the infringer's management body from exercising management functions over such undertaking.
- If applicable, a ban on making further STS notifications.

- Administrative pecuniary sanctions of up to €5,000,000 (or, even if in excess, up to twice the benefit derived from the infringement if the benefit can be determined).
- The Securitisation Regulation permits Member States to enact criminal sanctions instead of administrative sanctions for infringements of the Securitisation Regulation.

In addition, the Securitisation Regulation requires Member States to publish without undue delay (but after notification of the infringer) any non-appealable administrative sanction for infringement of the Securitisation Regulation. This requirement includes publishing the identity of the infringer and a description of the infringement; provided publication may be avoided, delayed, or anonymised in order to maintain the stability of the financial markets, to avoid jeopardising an on-going investigation, or in the case of minor infringements, Member States shall inform ESMA of all administrative sanctions and ESMA shall maintain a central database of sanctions that Member States communicate to it.

Regulatory Technical Standards

The Securitisation Regulation anticipates the development and adoption of regulatory technical standards in a number of areas:

- As with the existing risk retention rules, the EBA, in cooperation with the ESMA, is tasked with preparing draft regulatory technical standards relating to risk retention within six months of the entry into force of the Securitisation Regulation.
- ESMA, in cooperation with the EBA, is tasked with preparing draft regulatory technical standards relating to the registration of securitisation repositories and the collection, management, and provision of information to be held in respect of securitisations within one year following the entry into force of the Securitisation Regulation.
- ESMA, in cooperation with the EBA, is tasked with preparing draft regulatory technical standards relating to the exceptions to resecuritisations within one year following the entry into force of the Securitisation Regulation.
- The EBA, in cooperation with ESMA, is tasked with preparing draft regulatory technical standards relating to the homogeneity of assets for STS securitisations within six months following the entry into force of the Securitisation Regulation.
- ESMA, in cooperation with the EBA and EIOPA, is tasked with preparing draft regulatory technical standards relating to the information that must be supplied and the templates that must be used in connection with STS notifications within six months following the entry into force of the Securitisation Regulation.
- The EBA, in cooperation with ESMA, is tasked with preparing draft regulatory technical standards for synthetic STS securitisations (limited to balance sheet synthetic securitisations) within twelve months following the entry into force of the Securitisation Regulation.

For all of the foregoing matters, the Securitisation Regulation empowers the EC to supplement relevant EU regulations by adopting such standards.

Conclusion

The Securitisation Regulations will change significantly the regulatory landscape for securitisation transactions. The CRR Amendment Regulation will change the capital calculation methodologies for all securitisation exposures, generally increasing regulatory capital charges for those exposures. For certain simple, transparent, and standardised securitisation exposures, the Securitisation Regulation introduces new STS criteria which, if met, will generally result in even lower regulatory capital charges than under existing rules. Finally, the Securitisation Regulation unifies the risk retention, due diligence, and reporting rules applicable to all institutional investors. Institutional investors have time to adopt to the new securitisation rules prior to the proposed implementation date of January 1, 2019, but the clock is now ticking.

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Endnotes

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- ¹ The official text of the Capital Requirements Regulation can be found [here](#).
 - ² Unless otherwise defined herein, the terms in this *Client Alert* use the meanings set out in the Securitisation Regulation and the Capital Requirements Regulation.
 - ³ The IAA is permitted under the existing rules and is not covered further in this *Client Alert*.
 - ⁴ The Securitisation Regulation also sets out requirements for STS securitisations for ABCP conduits. Those requirements are beyond the scope of this *Client Alert*.
 - ⁵ It is not necessary that a sale be perfected (e.g., by notice to the debtors), provided that triggers permitting perfection include severe deterioration in the seller creditworthiness, seller insolvency, and unremedied seller breaches.
 - ⁶ The official text of MiFID II can be found [here](#).
 - ⁷ Namely, the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority (EIOPA).