
# EU SECURITISATION REGULATION – A STING IN THE TAIL?

The EU Securitisation Regulation, long in the pipeline, reached a significant milestone on 11 July when the provisionally agreed text was approved on behalf of the European Parliament (having previously been agreed on behalf of the Council on 28 June).

While in general this should be good news, there are some provisions introduced at a very late stage in the process that are very troubling for industry. While we are still considering the text overall – and these issues in particular – we thought it worth bringing a few late-emerging aspects of the regulation to the attention of industry immediately.

## A ban on securitising self-certified residential mortgage loans

Probably the most significant of these changes made at the very late stages of the process was a ban (in Article 17(2) of the provisionally agreed text) introduced on securitising residential mortgage loans "marketed and underwritten on the premise that the loan applicant or, where applicable, intermediaries were made aware that the information provided by the loan applicant might not be verified by the lender". This exclusion has long been in place for STS securitisations, but in the version of the text approved on behalf of the Council and Parliament, this appears to have been extended to all securitisations, whether or not STS and whether public or private. No provision has been made for regulatory technical standards or other secondary legislation or formal guidance that might be helpful in restricting the scope of this ban.

The ban is expected to apply to transactions where securities are issued on or after 1 January 2019, meaning it would apply to standalone transactions done after that date and any repeat issuance platforms (such as master trusts or ABCP conduits) that issue securities after that date. There is no *de minimis* exemption in the legislation – the legislation expressly says "the pool of… loans shall not include ***any*** loan" (emphasis added) that is self-certified.

If carried through to the final text published in the Official Journal, this would create significant problems not only for new transactions after 1 January 2019, however, but for existing transactions that need to be refinanced after that date. At the moment, RMBS transactions are almost universally priced on the expectation that the legal final maturity of the transaction is irrelevant because the deal will be redeemed via a call, typically structured to be used after 3, 5 or 7 years. In pools with significant proportions of self-certified loans, it may not be practically feasible for the originator or sponsor to refinance the portfolio through securitisation once the ban on securitising self-certified loans is introduced.

Although we understand that self-certified loans are no longer being originated, there is a significant stock of such loans originated prior to the 2007-08 financial crisis that remain on the books of a wide range of financial institutions who either originated them or have subsequently acquired these portfolios as part of the general trend of bank deleveraging that has occurred over the last few years. Consequently, this ban raises very serious questions about how this sizable stock of loans will be financed by way of RMBS to maturity.

To add to the confusion, the drafting of this ban is not clear and the context seems confusing. The drafting is done as an objective statement, with no clear imposition of an obligation on any particular party. There is also a question about how easily these loans will be able to be identified, because the borrower being "made aware" of the unverified nature of the underwriting is a key element of the prohibited class of loans. As to context, it was inserted in a portion of the legislation to do with credit granting criteria. This article is also otherwise solely forward-looking, so it is possible that the intention was to ban the future origination of self-certified loans (as opposed to banning the securitisation of legacy portfolios with this feature), but if that is true then the recently approved text of the regulation will need to be amended before publication in the

Official Journal, because the words on the page do not make this clear.

## Other significant issues

There have been several well-trailed issues discussed in the legal and industry press over the last two years (including our briefing on the original proposal, our update in May of this year and our discussion of the political agreement) and this alert does not propose to rehash those. There are, however, a number of problematic elements of the Regulation that were either introduced or modified at the very late stages of the process that industry should bear in mind.
These include:

1. **Grandfathering:** The grandfathering provisions of the Securitisation Regulation are seriously deficient. Despite long-standing and oft-repeated concern expressed by industry, the transitional provisions of the Securitisation Regulation do not provide for a regime based on the date a particular securitisation was established. Instead they are based on when securities are issued or – in the case of securitisations where no securities are issued – the date the initial securitisation positions are created. This means, for example, that a pre-existing master trust or ABCP conduit will need to comply with the new regulation from the date it first issues notes on or after 1 January 2019. This approach to grandfathering represents a significant departure from the previous model under CRD2, where existing platforms had a number of years to comply.

   The grandfathering rules are further deficient in that they set out a regime where some transactions will have to comply with two different sets of rules during their life. This is because a number of the regulatory technical standards expected are unlikely to be in place by 1 January 2019 when the Securitisation Regulation begins to apply. Until those new RTS are fully in place, transactions issued will need to comply with the existing RTS on risk retention (adopted under the CRR) and transparency (adopted under Article 8b of the Credit Rating Agencies Regulation). Then, once the new RTS are in place, those same transactions will immediately become subject to the new rules. This puts market participants in a particularly invidious position. At the very least it might require restructuring of deals to adapt to the new RTS. At worst it might require some deals to be unwound if, for example, the risk retention structure needs changing for technical reasons in a way that is not feasible during the ongoing life of the transaction as a result of the introduction of the new RTS.

2. **Suitability tests:** To the extent that notes are sold to "retail clients" (as defined in MiFID2), suitability tests will need to be done and quantitative criteria around minimum holdings and proportions of the client's portfolio will need to be met. This is problematic because the regulation explicitly requires that the seller conduct the suitability test, a role one would normally expect to be played by the buyer's broker or some other intermediary. Of course the proportion of retail clients investing in securitisations will be small, but a number of regional and municipal authorities might be retail clients, for example, so this cannot be dismissed out of hand. That said, there will be other regulatory imperatives to avoid selling to retail clients (notably the PRIIPs Regulation) so the solution may simply be to avoid these sales altogether.

3. **Timing of disclosure:** The latest version of the legislation requires that certain information be made available before pricing. Unhelpfully, it does not specify that this information can be made available in "draft or initial form" (as it does for similar requirements elsewhere in the legislation). Given that the information to be disclosed before pricing includes, among other things, the final prospectus and deal documents, that will be impossible to provide in anything but "draft or initial" form.

4. **Disclosure of private transactions:** Much was made by industry of the need to exclude private transactions from the reporting requirements imposed on public deals and late in the legislative process it seemed that this concern had been heeded.
   The approved text, however, appears only to exclude private transactions from the obligation to report data to public securitisation repositories.
   It would appear from the text that private transactions will still be subject to the obligation to report the information prescribed in detail by the legislation in the appropriate format and on the same timescales as for public deals – a requirement that is surely unworkable.

5. **Environmental disclosure:** The regulation now requires as one of the STS criteria that the loan-level data reported on residential and auto assets include information as to the

environmental performance of the assets. In addition to undoubtedly requiring amendments to the existing templates on which loan-level data is currently reported, it is not at all clear what information will need reporting or how and when that will be specified – making it very difficult for originators to begin collecting that information. Further clarification may be provided through official guidance but the mechanism by which this would happen is not yet clear.

6. **Ban on resecuritisation:** Finally, the ban on resecuritisation is problematic in that it is not clear how the ban operates. It does not create any obligations on any particular market participant or category of market participants. This, of course, makes the ban very difficult to manage as a practical matter, as it is not clear whose responsibility it is to check there is no resecuritisation. It also makes determining the geographic scope of the ban very difficult. Further, although ABCP is excluded from the ban, it is not excluded from the definition of a resecuritisation, thereby suggesting that the legislator might consider ABCP a "permitted" resecuritisation – with attendant negative consequences on capital charges, among other things. We do not think this is the better reading of the legislation, but the drafting is certainly unhelpful.

## Conclusion

Despite the tireless and continuing efforts of a number of industry associations to communicate the problems, there remain a large number of outstanding troublesome issues with the Securitisation Regulation. While things are still changing and the process is not yet finished, it seems clear that industry is going to have to live with a number of these issues in one way or another. That said, because the process is not completely finished there is still some – admittedly very limited – scope to make amendments. That window is closing, however, so to the extent clients wish to make final representations to attempt to persuade the authorities on the above (or any other) points, they should do so quickly.

C L I F F O R D

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## AUTHORS


**Maggie Zhao**
**Partner**
**London**
T: +44 20 7006 2939
E: maggie.zhao@cliffordchance.com

**Andrew Bryan**
**Senior PSL**
**London**
T: +44 20 7006 2829
E: andrew.bryan@cliffordchance.com


## CONTACTS


**Stephen Curtis**
**Partner**
**London**
T: +44 20 7006 2281
E: steve.curtis@cliffordchance.com

**Andrew Forryan**
**Partner**
**London**
T: +44 20 7006 1419
E: andrew.forryan@cliffordchance.com

**Kevin Ingram**
**Partner**
**London**
T: +44 20 7006 2416
E: kevin.ingram@cliffordchance.com

**Emma Matebalavu**
**Partner**
**London**
T: +44 20 7006 4828
E: emma.matebalavu@cliffordchance.com

**Simeon Radcliff**
**Partner**
**London**
T: +44 20 7006 2786
E: simeon.radcliff@cliffordchance.com

**Chris Walsh**
**Partner**
**London**
T: +44 20 7006 2811
E: christopher.walsh@cliffordchance.com




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