EBA PUBLISHES GUIDANCE ON SECURITISING ACQUIRED PORTFOLIOS

On 13 September 2019, the European Banking Authority published a long-awaited piece of guidance in relation to the securitisation of acquired portfolios. The Q&A clarifies the obligations of securitisation originators under Article 9 of the EU Securitisation Regulation ("**EUSR**") to verify the credit granting standards used to originate securitised assets. While not as clear as it might have been, the Q&A nonetheless provides welcome comfort to portfolio acquirers on how to comply.

GENERAL BACKGROUND

We have recently seen significant portfolio disposals across a number of jurisdictions, including the UK (where UKAR has continued its programme of disposals of the legacy Northern Rock and Bradford and Bingley mortgage books, in particular) and Ireland (where Lloyds Bank, KBC, Danske and Rabobank have all sought to exit their Irish mortgage businesses). Many of these legacy mortgage portfolios are extensively seasoned and often predominantly originated before the financial crisis in accordance with the standards of the time. Although much is known about the credit characteristics of these books (due largely to extensive seasoning), the passage of time often means that access to the origination policies relevant at the time and personnel familiar with the origination of the book can be difficult or patchy. These problems become even more acute where portfolios are made up of assets from multiple originators brought together through merger or otherwise. In this context, Article 9 of the EUSR has, since 1 January of this year, presented some complex issues, especially given the frequent use of securitisation exits made by portfolio acquirers.

In our publication "Testing the New Foundations" (released in June 2019) we spoke of the need for official guidance in order to clarify the basis upon which transactions can sensibly proceed while complying with Article 9(3) EUSR. On 13 September the European Banking Authority published a Q&A on the Article 9 obligations (to verify that the credit granting standards used to originate securitised assets were the same sound and well-defined standards used to originate non-securitised assets) providing welcome guidance to the market (the "**EBA Guidance**").

Key issues

- The Securitisation Regulation began to apply on 1 January 2019, bringing in certain diligence requirements for portfolio acquirers looking to securitise acquired assets.
- Article 9(3) requires that originators verify that exposures to be securitised (i) were originated using the same sound and well-defined criteria for credit granting that the original lender applied to its non-securitised exposures, and (ii) were subject to effective systems in place at the time of origination to ensure that credit-granting is based on a thorough assessment of the obligor's credit worthiness.
- Market participants had voiced concerns that a narrow interpretation of the requirements could lead to the securitisation of seasoned assets being functionally prohibited due to a lack of origination information, even where such information was not needed to understand the current performance characteristics relevant to obligor performance.
- The EBA has now published a Q&A that goes some way to reassuring market participants that these assets can be securitised provided that proper diligence is conducted and the results (including any gaps) are properly disclosed.

A RECAP ON ARTICLE 9(3) OF THE SECURITISATION REGULATION

By way of recap, Article 9(3) is the most relevant part of Article 9 for acquired portfolios. It provides that where an originator purchases a third party's exposures for its own account and then securitises them, that originator has to check that the asset creator (normally the original lender) applied the same origination standards to the securitised assets as to non-securitised exposures. The originator must also verify that there were clearly established processes around extending, amending and otherwise administering the securitised loans, as well as for checking the obligor's creditworthiness. Clearly, there are challenges for acquirers of historic mortgage pools in meeting these requirements, but fortunately there are sensible ways of approaching them in a manner workable for the mortgage trading market, in respect of which additional comfort can be found in the EBA Guidance. It should be noted that there is a slightly different test applicable where the underlying assets to be securitised were originated before the 21 March 2014. This arises from the preservation of an old test applicable to banks under the securitisation rules of the Capital Requirements Regulation.

HOW SHOULD THE TEST BE APPLIED?

Securitised vs non-securitised exposures

The first part of the Article 9(3) test should be the most manageable. While the wording on its face suggests a test that might be quite onerous (because you would need detailed knowledge of the origination of both the assets proposed to be securitised and contemporary non-securitised assets), we – along with most of the market – had taken the position prior to the EBA Guidance that the spirit of the provision is actually much more straightforward to comply with.

The market had been approaching transactions on the basis that Article 9(3) amounts to a requirement on the originator to establish that the pool of mortgages was not created as an 'originate-to-distribute' pool. This is to guard against the inclusion of assets in a securitisation that were deliberately created of a lower credit quality with the sole purpose of being securitised. Due diligence at the point of acquisition should in most cases be able to establish this by looking at factors such as pool selection and loan features. The key test here is the difference between approaches taken to securitised and non-securitised exposures. The test is even easier where all of the assets within a defined business line are sold, as this reinforces that different criteria could not have been applied to securitised and non-securitised exposures.

For portfolios that were originated in the context of an originate-to-distribute business model, it may be that the situation can be remedied by e.g. re-underwriting the relevant loans. Portfolio acquirers will need to look at the detail of the origination standards and criteria at the time and consider carefully how to approach the Article 9(3) issues lest they find themselves unable to access the securitisation markets for financing.

How the EBA Guidance supports this approach

The EBA Guidance provides helpful support for this approach. The European Banking Authority confirmed in the EBA Guidance that one of the purposes of Article 9(1) of the Securitisation Regulation was "to prevent that exposures of lower credit quality are created with the sole purpose of being securitised" on or after 1 January 2019. This reaffirms the statement above that the spirit of the provision is to check whether the assets to be securitised came from an 'originate-to-distribute' model as opposed to a more granular test retrospectively looking at origination across a wider origination business that may not be possible in most cases. Although the EBA Guidance does not go as far as to say explicitly that it is acceptable to securitise assets where the origination criteria cannot be verified, its emphasis on using "adequate resources" and making "reasonable efforts" to "obtain as much information as is available and appropriate for such verification in accordance with sound market standards of due diligence for the class of assets and the nature and type of securitisation" suggests very strongly that a responsible and thorough due diligence process based on the available information will be sufficient to fulfil the Article 9(3) obligation.

Assessment of obligors' creditworthiness

The second part of the test, in relation to clearly established origination processes, is more complex as it involves more subjective and portfolio specific analysis as to current performance. The requirements of the second part of Article 9(3) require an assessment and consideration of the exposures to be securitised and their current performance characteristics in order to verify the prospect of the relevant underlying obligor meeting its obligations under its credit agreement. The approach the market had taken before the EBA Guidance was that it will be important for portfolio acquirers to record the diligence in this respect and to identify any issues that have arisen from that diligence, including any gaps in the diligence that could be undertaken. It is expected that practice will develop such that the gaps are reflected in the disclosure in the prospectus. In this way, the spirit of the legislation can continue to be met, by ensuring that investors have (as much as possible) the same information as originators when making investment decisions. The adequacy of the level of disclosure should be considered by reference to the nature of the portfolio and market practice.

Due diligence in relation to original lending practices is therefore key and originators will need to take into account the circumstances relating to the purchase of the assets and the type of securitisation. Factors will vary across portfolios, including any collateral, seasoning, delinquency, and restructuring arrangements/payment plans, etc.

How the EBA Guidance supports this approach

The EBA Guidance again provides helpful support for this approach. The European Banking Authority confirmed in the EBA Guidance that the "verification should ascertain through appropriate means that the original lender fulfilled the requirement" (emphasis added) and (as quoted above) that the originator "should use adequate resources and make reasonable efforts to obtain as much information as is available and appropriate for such verification in accordance with sound market standards of due diligence for the class of assets and the nature and type of securitisation" (emphasis added). Accordingly, portfolio acquirers will need to be careful to ensure they meet or

exceed prevailing market standards of due diligence on the current nature and performance of the exposures and use reasonable efforts to obtain as much information as practicable in order to make their assessment (and inform disclosure to investors) on factors such as collateral values, legal and regulatory framework of the exposures, loan and servicing documentation and performance in order to satisfy themselves that they have complied with the requirement to “verify” both the origination standards and credit processes.

In other words, following best practice in the market and using best efforts to obtain and work through the available materials on the portfolio will be key tests for portfolio acquirers to bring securitisations to market backed by pools of historic mortgages. This is helpful guidance to allay concerns that the requirements of Article 9(3) amounted to a requirement to re-underwrite assets where the information needed to do so may not be available.

WHAT THIS MEANS FOR INVESTORS

The disclosure of diligence by portfolio acquirers will also be helpful for investors who are themselves subject to due diligence obligations under the Securitisation Regulation. In particular, investors will also have certain obligations to verify that the assets were verified according to “sound and well-defined criteria” as well as checking certain requirements are met around processes for originating and administering the underlying assets. This aspect of the due diligence obligations does not apply, however, where the originator or original lender is a regulated bank (a "credit institution" or "investment firm" in the technical parlance) established in the EU.

The result of both the acquirer and investors having requirements to check origination is likely to be that transactions will have a further increased focus on these origination criteria and processes and how these are disclosed, either in offering materials or (where there are none) in financier shadow diligence for private securitisation transactions.

In the EBA Guidance, the European Banking Authority did give thought to this, noting that the verification requirements should be interpreted without prejudice to such disclosure requirements.

CONCLUSION

Although it would ideally have been clearer, the EBA Guidance is making Article 9(3) compliance look more manageable than initially feared. It helpfully provides guidance on certain systemic issues flagged by market participants and clearly aims to align the approach to Article 9(3) with what is possible in light of the realities of acquired portfolios and also with existing best practice in the market. While each individual portfolio will of course need to be assessed in light of what is available and practicable at the time of securitisation and issues will no doubt arise, market participants now have welcome guidance on how to navigate these issues and the approach to take based on current market best practice.

CLIFFORD
CHANCE

AUTHORS

Andrew E. Bryan
Knowledge Director

T +44 207006 2829
E Andrew.Bryan
@cliffordchance.com

Adam Craig
Senior Associate

T +44 207006 8862
E Adam.Craig
@cliffordchance.com

Kevin Ingram
Partner

T +44 207006 2416
E Kevin.Ingram
@cliffordchance.com

CONTACTS

José Manuel Cuenca
Partner

T +34 91 590 7535
E josemanuel.cuenca
@cliffordchance.com

Stephen Curtis
Partner

T +44 207006 2281
E steve.curtis
@cliffordchance.com

Louina Czupper
Partner

T +32 2 533 5987
E louina.czupper
@cliffordchance.com

Andrew Forryan
Partner

T +44 207006 1419
E andrew.forryan
@cliffordchance.com

Dr. Oliver Kronat
Partner

T +49 69 7199 4575
E oliver.kronat
@cliffordchance.com

Jonathan Lewis
Partner

T +33 1 4405 5281
E jonathan.lewis
@cliffordchance.com

CONTACTS

Emma Matebalavu
Head of London Finance

T +44 207006 4828
E emma.matebalavu
@cliffordchance.com

Marc Mehlen
Partner

T +352 48 50 50 305
E marc.mehlen
@cliffordchance.com

Simeon Radcliff
Partner

T +44 207006 2786
E simeon.radcliff
@cliffordchance.com

Tanja Svetina
Partner

T +39 02 8063 4375
E tanja.svetina
@cliffordchance.com

Pieter van Welzen
Partner

T +31 20 711 9154
E pieter.vanwelzen
@cliffordchance.com

Christopher Walsh
Partner

T +44 207006 2811
E christopher.walsh
@cliffordchance.com

Maggie Zhao
Partner

T +44 207006 2939
E maggie.zhao
@cliffordchance.com