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CHANCE

THE FUTURE OF THE EU SECURITISATION REGULATION

The EU Securitisation Regulation (**EUSR**) is just over 2 years old, but already the review process is in full swing. In the last year, we have had several indications of the direction that review might take. In this briefing, we examine a couple of recent publications from the European Supervisory Authorities (**ESAs**) for indications as to the direction of travel and the challenges ahead and attempt to put them in a broader regulatory, policy and political context.

Key issues

- The EUSR is due for a review by the end of this year and amendments to the level 1 text are likely to be proposed.
- The ESAs have recently published two key documents making suggestions for changes to the regime.
- One key area of focus is the jurisdictional scope of application of the EUSR, which has always been uncertain. Some of the changes proposed by the ESAs in this area would be very disruptive to industry.
- On the investor side, the jurisdictional scope recommendations would make it very difficult for EU regulated investors to invest in non-EU securitisations.
- On the sell side, the jurisdictional scope recommendations would create significant problems, especially for cross-border transactions (where both EU and third-country entities are involved on the sell side).
- The ESAs also appear to be proposing a reimagining to the public/private distinction in securitisation. The proposals include a much narrower definition of a "private" securitisation and making most deals currently thought of as "private" report to securitisation repositories.

BACKGROUND

The EUSR began to apply to securitisations on 1 January 2019. As with any new piece of legislation, experience and practical realities have thrown up a number of challenges, ambiguities and differences of opinion about the correct interpretation and application of the new regime ever since. While a great number of these have been resolved (thanks in no small part to ESMA's 100+ page Q&A along with a raft of other regulatory and implementing technical standards, guidelines and Q&As prepared by ESMA and EBA), several others remain outstanding. Market practice has plugged a number of these gaps, but important areas such as the scope of the "sponsor" definition, the obligations of EU institutional investors when investing in third country securitisations and the reporting of private securitisations to competent authorities have remained sources of unhelpful ambiguity and hence uncertainty.

All of this is before the EUSR regime is even complete. The ESAs have worked very hard to put out appropriate level 2 and 3 measures to complete the regime, but despite those efforts, important pieces of the puzzle like the regulatory technical standards on risk retention remain to be finalised. As of the time of writing, there was also not a single securitisation repository authorised by ESMA, despite such repositories' central role in the management of securitisation data as envisaged by regulators and policymakers.

Despite this, the European Commission is required to present a report on the implementation of the EUSR (accompanied, if appropriate, by a legislative proposal) to the European Parliament and the Council by 1 January 2022. A number of clues as to the general direction of travel and the Commission's thinking have emerged in the last year, including the Final Report of the High Level Forum on the Capital Markets Union (the "**HLF Report**") and the

Commission's updated Capital Markets Union 2020 action plan (the "**CMU 2020 Action Plan**"). More recently, the ESAs have published their own review report on the Securitisation Regulation (the "**Review Report**") as well as a standalone Opinion on the jurisdictional scope of application of the EUSR (the "**JSA Opinion**") and a joint ESAs Q&A document on certain EUSR questions.

The main focus of this briefing will be on the most recent documents published by the ESAs, especially the JSA Opinion and the Review Report, but it is important to bear in mind the broader picture showing the Commission's generally positive thinking (including the HLF Report and the CMU 2020 Action Plan) about securitisation and the role in can play in the real economy. Also relevant is the continued wariness and less positive political attitude in the EU towards securitisation demonstrated most recently in the context of the political engagement on the EUSR and Capital Requirements Regulation amendments passed as part of the Capital Markets Recovery Package earlier this year.

THE ESAs' MAIN RECOMMENDATIONS

Between the JSA Opinion and the Review Report, the ESAs made several recommendations. We will look at these recommendations thematically, predicated on reading the two documents together. The recommendations can broadly be categorised into three areas: sell-side obligations, buy-side obligations and STS. The overarching thrust of the recommendations in general, though, is one of providing more information to regulators. It would appear that, implicitly, the ESAs and national competent authorities still feel the need to understand the securitisation market better, and their chosen way to do that is to ensure wherever possible that market participants are within the EU's scope of supervision and they make as much information as possible available to the authorities.

It is also important to bear in mind when reading these recommendations that the scope of the mandate the ESAs had was limited. The ESAs' recommendations therefore do not cover some of industry's urgent regulatory priorities such as CRR and Solvency II capital weightings, LCR inclusion (and categorisation), significant risk transfer assessments and a number of others – not because they are unimportant, but simply because they are out of scope of this particular exercise.

SELL-SIDE OBLIGATIONS

The two sets of recommendations in these areas that are of most concern to market participants are to do with jurisdictional scope and the nature of the disclosure obligations.

Jurisdictional scope

The ESAs' central recommendation is that the EU should deal with cross-border issues by ensuring that all obligations fall on EU entities wherever possible. That is to say, where there are sell-side entities both in the EU and out of it, those parties located in the EU should be responsible for carrying out the regulatory obligations associated with the securitisation, including risk retention, disclosure and checking credit-granting standards.

The stated reason for this recommendation is a desire to ensure more effective regulatory oversight by ensuring the entities with responsibility for carrying out obligations are within the reach of EU regulators. On its face this is not an unreasonable motivation but, as we shall see below, this is often unnecessary to achieve the regulatory objectives and ignores the commercial realities in a way that would make the regime difficult or impossible to apply in a number of common circumstances.

- On **risk retention** the ESAs' jurisdictional scope proposal means where the originator, sponsor and original lender are not all in the EU "the party or parties…located in the EU should be the sole responsible for retaining the net economic interest in the transaction"[1]. In addition to the many obvious possible conflicts with existing rules about who is allowed to retain, it is problematic because it fails to take account of the fact that the choice of risk retainer is usually driven largely by commercial factors. A couple of examples may be illustrative:
  - If an EU bank sells a portfolio to an American fund who finances that acquisition via a securitisation, would the ESAs have the EU bank do the risk retention (as original lender) despite otherwise not being a party to the securitisation?
  - What about a multi-seller trade receivables securitisation where the Japanese parent company holds the retention on behalf of all the operating companies in the group who sell receivables into the deal? It would be perverse of the EU operating subsidiary had to hold the retention for the whole transaction despite contributing e.g. 10% of the assets.
- On **disclosure**, this means designating an EU party among the originator, sponsor and issuer (or SSPE, in EUSR parlance) as the entity required to actually do the mechanical job of reporting all of the required information to investors and competent authorities. While it is possible for this to be done, it also doesn't seem to meaningfully support a valid regulatory objective, since all three of the originator, sponsor and issuer are jointly liable for complying with the disclosure obligations already. The only impact of this recommendation seems to be that it will sometimes create an unnecessary administrative burden as a non-EU servicer reports to the relevant EU entity who then carries out the mechanical process of fulfilling the regulatory obligation – a process that EU entity may need to incur extra cost to do if it is not already set up to do so.
- On **credit-granting standards**, the ESAs recommend that "where one or more of the securitisation's sponsor, originator or original lender are located in a third country, the party or parties located in the EU should be responsible for ensuring that" Article 9 of the EUSR is complied with and, in particular that the assets have applied to them "the same processes for approving and renewing credits as non-securitised exposures". Article 9 has always been slightly difficult to apply. In particular, it is very awkward to apply to:
  - **seasoned portfolios**, where the original credit granting is no longer relevant to current credit quality and the records of the original credit granting may not have been retained, even by the entity that did it.

[1] JSA Opinion, para. 19.

- **acquired portfolios**, where the "originator" is not granting the credits in the first place and may not be able to check the original credit granting because the original lender may have disposed of the records or may no longer exist.
- **securitisations with a sponsor** (who, by definition, will not be granting the credits), such as ABCP programmes.
- **forward flow transactions**, where the basis of comparison with "non-securitised exposures" is unclear because the intention is to securitise all of the assets originated by the lender.

For many of the same reasons, requiring that an EU entity who is not the natural, commercially appropriate lender to have underwritten the individual underlying assets to ensure compliance with Article 9 of the EUSR is highly likely to be awkward at best and impossible in many cases.

Transparency obligations

In addition to the adjustments to the transparency rules set out in the jurisdictional scope section below, the ESAs are recommending a significant restructuring of the way disclosure is carried out for securitisations.

Currently, public and private securitisations have relatively similar disclosure rules. They all have to report broadly the same information on (mostly) the same templates. The main consequence of being a "public" securitisation (one where you have to publish a prospectus) is that public securitisations carry an obligation to report via a securitisation repository – an obligation that has been theoretical so far since no securitisation repositories have yet been authorised by ESMA. The reporting entity on a private deal (broadly, any deal not admitted to trading on an EEA regulated market) must ensure much the information is made available to the right people (investors, competent authorities and, upon request, potential investors) but there are no mechanical rules about how that must be achieved. Some EU Member States (including the UK before the end of the Brexit transition period) have national directions regulating how information about private securitisations is to be given to competent authorities, but most do not.

The overarching theme of the ESAs' proposals for change to this system is one of getting more information to competent authorities in a format they find easy to work with. Those proposals include:

- Ensuring that the reporting entity is in the jurisdictional reach of EU regulators as outlined above.
- Narrowing the definition of a private securitisation in an unspecified way, but it is clear that the ESAs believe the current definition is too broad. One possibility they raise is limiting it to intragroup transactions with no third-party investors, and then excluding those securitisations from formal reporting obligations under Article 7 of the EUSR entirely.
- Requiring most securitisations currently categorised as private to report to securitisation repositories. The justification for this appears to be one of market surveillance. The ESAs complain that "it is difficult for supervisory authorities to become aware of the issuance of private securitisations if they are not notified and even when competent authorities are notified, it is difficult to access the information relating to a private securitisation, since it

is not available via a securitisation repository"[2]. They go on to express concern that "there is already some evidence indicating that in some cases competent authorities were not informed [of private securitisations] and in other cases, the templates were not correctly reported. Furthermore, there is uncertainty in the market on the reporting requirements for private securitisations, in particular when there are different competent authorities to whom the information under Article 7(1) of the [EUSR] should be made available."[3]

As with the jurisdictional scope proposals, it is arguable that the justifications for the transparency proposals are superficially credible, but nevertheless they do not give sufficient weight to critical commercial considerations. While some "private" securitisations are widely distributed and listed on relatively public multilateral trading facilities (MTFs) such as the Irish Stock Exchange's Global Exchange Market (GEM), others genuinely are – for good reason – private arrangements, including bilateral financings. A significant number of synthetic securitisations, for example, are done on a private basis because the originator banks need to keep tight control over their asset-level disclosure. This is to avoid their competitors obtaining competitively sensitive data about the assets they originate and their business strategy more broadly. In these cases, prospective investors would not be allowed to obtain deal information unless approved by the originator and then only after signing non-disclosure agreements (NDAs). Forcing originators to report to securitisation repositories would cause them to lose that control over their information and risks acting as a serious disincentive to entering into such transactions at all.

While there is almost certainly a discussion to be had around whether to adjust the placement of the divide between public and private securitisations, the proposal that all securitisations subject to reporting obligations should do so via securitisation repositories is disproportionate. It also seems a curious first step in context, since most of the problems complained about by the ESAs could sensibly be addressed in the first instance by a combination of national competent authorities putting in place guidance for reporting private transactions and by ESMA authorising at least one securitisation repository. We are aware of market participants struggling to advise their competent authorities of private securitisations, for example, because the relevant competent authorities are not set up to receive that information – despite having had two and a half years to put appropriate arrangements in place.

It seems clear that the ESAs propose reporting via securitisation repositories as the solution to a significant number of their concerns. It is hard to see how they are able to assess the experience, though, because not a single securitisation repository has been authorised yet, so there has been no collection and distribution of data via that route so far.

Moreover, the proposals for increased transparency and repository reporting ignore existing prudential reporting systems in place under various pieces of sectoral legislation. Banks, for example, do regular, detailed COREP reporting, and other regulated entities have similar systems. This is how supervisors collect information on other, non-securitisation types of exposures, such as bank loans, corporate bonds, covered bonds and finance leases. It is unclear why those same systems (possibly with some targeted adjustments, if required) would not be sufficient to address any deficiencies in information the

[2] Review Report, paragraph 68.
[3] Review Report, paragraph 69.

authorities can access to supervise securitisation markets. Adopting such an approach would not only be more consistent, it would get the competent authorities the information they need in a format they are accustomed to all the while addressing the legitimate commercial confidentiality and cost concerns of market participants associated with repository reporting.

BUY-SIDE OBLIGATIONS

On the buy side, the ESAs have made a number of proposals for change, some of which are helpful and will be welcomed as such, and some of which are problematic and, once again, fail to give sufficient weight to market realities and commercial concerns. The proposals can be grouped as follows:

- Proposals to clarify the regulation around how and when EU institutional investors may invest in third country securitisations.
- Proposals to clarify the nature and extent of the due diligence obligation – including the consequences of an investor delegating some or all of its due diligence obligations.
- Proposals to clarify which fund managers are in scope of the EUSR.

We consider each, in turn, below.

Proposals to clarify the regulation around how and when EU institutional investors may invest in third country securitisation

These proposals arise out of the lack of clarity in the wording of Article 5(1)(e) of the EUSR and the absence of official guidance in any form regarding its application. The provision requires EU institutional investors to verify, as a pre-condition of investing in a securitisation, that "the originator, sponsor or SSPE has, **where applicable**, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article." (emphasis added) The meaning of the words "where applicable" in this context has been the subject of divergent interpretations across the market since the beginning of 2019, when the EUSR began to apply.

In essence, institutional investors have had to decide whether:

- the words "where applicable" refer to the fact that not all elements of disclosure provided for under Article 7 apply to all deals, in which case investors need only verify they are getting the relevant bits of disclosure (e.g. no transaction summary under Article 7(1)(c) is required for a public deal). In this scenario, institutional investors would need full EU-style disclosure (as provided by Article 7 of the EUSR) in order to meet their regulatory due diligence requirements regardless of whether any sell-side entity was directly subject to Article 7; or
- the words "where applicable" mean "where Article 7 is directly applicable to a sell-side entity", in which case investors would not need full EU-style disclosure from third country entities and could make their own judgment as to whether they were getting sufficient disclosure to make an informed investment decision when investing in third country securitisations.

Despite repeated requests for guidance on this point, none had been forthcoming prior to the JSA Opinion. Consequently, no particular market

consensus has emerged, with institutional investors taking a range of positions from the very risk-averse to the very robust and everything in between.

Ideally, any ESA clarification would be limited to a prospective approach (grandfathering investment decisions made before it came out) and should take account of the need for EU institutional investors to have a range of global investment options to produce the best possible returns for their stakeholders. The ESAs' proposals unfortunately do neither.

The essence of the proposal is to clarify the ability of EU institutional investors to invest in third country securitisations by creating an equivalence regime for third country securitisations. According to the proposals, EU institutional investors would only be able to invest in securitisations where the reporting either complied directly with EU disclosure rules or the disclosure rules of a jurisdiction judged by the European Commission to be equivalent. Given the ESAs' recommendation that equivalence be granted only where the third country (i) requires disclosure of the same or substantially the same information, (ii) with "sufficient frequency" and (iii) in the form of disclosure templates of similar quality and granularity to EU ones, it seems very unlikely equivalence decisions would be granted for any country bar perhaps the UK.

Worse, the proposals start from an assumption that Article 5(1)(e) is unambiguous. The ESAs assume that, in order for investors to successfully comply with their diligence obligations under Article 5(1)(e) of the EUSR, the relevant third country reporting entity would need to provide disclosure that matches strictly that which would be required of it were it based in the EU. They say:

> "While it is noticeable that Article 5(1)(e) is silent on the location of the transaction parties, the obligation to verify that the originator, sponsor or SSPE has complied with Article 7 of the [EUSR] may be understood as including third country securitisations, where the party responsible for making the disclosures would be located outside the EU"[4]

They go on to say:

> "In particular, given the reference to complying with the 'frequency and modalities' of disclosure referred to in Article 7 of the [EUSR], it seems that the third country securitisation would have to use ESMA templates or, at a minimum, templates with the same content, and that those be disclosed with the same frequency as that of ESMA's…Furthermore, there is no flexibility within Article 5(1)(e) of the [EUSR] to waive or modify generally for a third country, or on an ad hoc basis for a transaction, concrete transparency requirements."[5]

Finally, they acknowledge that the result of this is that:

> "it seems very unlikely, or at least very challenging, that EU-located institutional investors would currently be able to discharge the requirement set out in Article 5(1)(e) of the [EUSR] in relation to third country securitisations, as a result of which they will not be able to invest in them."[6]

While resolution of this ambiguity is in principle desirable, this way of clarifying has created anxiety in the market partly because it suggests that the strict

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[4] JSA Opinion, paragraph 34
[5] JSA Opinion, paragraph 36.
[6] JSA Opinion, paragraph 37.

approach should have been followed by institutional investors all along. It leaves institutional investors who have taken a more robust (but hitherto reasonable) approach in an awkward position. Needless to say, it also imposes disproportionate restrictions on EU institutional investors' access to global markets.

The situation has been further muddled by the subsequent publication of the Review Report, where the ESAs seem to no longer maintain the stark clarity they had reached in the JSA Opinion less than two months previous. In the Review Report they refer to the EUSR being "ambiguous as to whether the obligation to verify compliance with the disclosure and reporting requirements should apply when the relevant parties are located outside the EU"[7]. In particular, they specify that "the words 'where applicable' are imprecise as to whether it should be understood as [meaning verification of compliance with the disclosure requirements is not applicable when the originator, sponsor or SSPE is not located in the EU, hence not directly subject to the EU disclosure requirements] or as stating that not all elements of Article 7 are applicable although verification of compliance with some part of Article 7 is required"[8].

While all of this is confusing, the different appraisal by the ESAs in the Review Report on this point does allow institutional investors to maintain policies that have previously taken a more flexible approach to Article 5(1)(e) until there is more definite clarification of the position at level 1. Moreover, it would seem disproportionate for any regulator to impose sanctions on one of its charges for failing to correctly parse a provision that even the ESAs can't decide how to interpret.

Proposals to clarify the nature and extent of the due diligence obligation

In this category, the ESAs make three recommendations:

- **Proportionality:** The due diligence obligations in the EUSR are articulated using concepts of proportionality and appropriateness, making clear that the same level of diligence will not be required in all cases. The ESAs are concerned, however, that there is no further detailed guidance about how these concepts should be applied. They worry both that this makes it more difficult for new investors or small investors to understand their obligations and that it makes supervision of diligence obligations more difficult for supervisors. In general, the market consensus is that clarification in this area would be very welcome. We are aware that many investors already routinely apply proportionate approaches to their diligence obligations, adjusting the diligence exercise according to factors including the size of the proposed investment, its credit risk/attachment point and length of time they expect to hold it. The authorities should be encouraged to consult with industry and engage in consideration of its proposals before formulating more detailed rules in this area, as there is existing market practice that functions well and could usefully be adopted and put on a more formal footing.
- **Loan-level due diligence:** In this respect, the ESAs express the view that "[d]ue-diligence at loan-level is essential to ensure that investors have an accurate understanding of the value and of the risk associated with the

[7] Review Report, paragraph 20(ii).
[8] Review Report, paragraph 20(ii).

securitisation exposures"[9] and they propose to modify the due diligence rules to explicitly require that institutional investors conduct due diligence at loan level. With respect, this proposal seems overbroad. For non-granular portfolios, particularly with large individual exposures, it is clearly necessary to understand each individual asset. Requiring the same level of detailed, asset-by-asset diligence of a highly granular portfolio of small exposures, particularly when revolving, is not sensible and ignores the portfolio effects that begin to appear in such circumstances. That is to say, having a detailed understanding of the creditworthiness of the obligor who owes €150m out of a €300m CMBS deal is important. Having the same detailed understanding of the obligor who owes €50 in credit card debt for one period in a €500m portfolio is not; and it is certainly less important than understanding the general features and behaviour of the portfolio as a whole. Consequently, overall, it would seem much more justifiable and practical to us to make any requirements for institutional investors to undertake loan-level diligence part of the overall proportionate diligence guidance.

- **Delegation rules:** The ESAs are also concerned that the ability of institutional investors to delegate their due diligence obligations (along with regulatory liability for failure to fulfil those obligations) to an asset manager under Article 5(5) of the EUSR conflicts with the sectoral rules applicable to AIFMs and those applicable to UCITS management companies. The AIFM and UCITS rules generally require that the fund manager retains full responsibility for the delegated functions. It is doubtful, however, there is any actual conflict to resolve. The ability or otherwise of fund manager to delegate responsibilities will always be governed by the relevant sectoral rules, as will the allocation of responsibilities as between the fund manager and the fund investors. The only thing Article 5(5) does is to provide a regulatory switch so that where:
  - (i) the delegate is itself an EU institutional investor;
  - (ii) the delegate has authority to make investment decisions on behalf of the principal that includes investments in securitisations; and
  - (iii) the principal instructs the delegate as part of the arrangement to comply with the principal's obligations under Article 5 of the EUSR,

  then the regulatory responsibility under Article 5 shifts to the delegate. This kind of shift in regulatory responsibility may be unique to securitisation, but so is the level of detailed regulatory intervention in the specific due diligence that must be done by institutional investors as set out in Article 5. The fund manager's overall responsibility to its fund investors remains (including in respect of the securitisation investment), as do its regulatory responsibilities under its sectoral regulation. Barring the clarification of which fund managers are institutional investors (as to which, see below) this is an area that does not need amendment or clarification.

Proposals to clarify which AIFMs are in scope of the EUSR

Finally, the ESAs raise a number of questions about which AIFMs should be in scope of the definition of "institutional investor" in the EUSR. The current definition simply states that an institutional investor includes "an [AIFM] as

[9] Review Report, paragraph 26.

defined in [AIFMD] that manages or markets alternative investment funds in the Union". This is fine as far as it goes, but lacks detail and clarify, in particular in respect of small (so-called "sub-threshold") AIFMs and also in respect of third country AIFMs.

- **Sub-threshold AIFMs:** Under the AIFMD regime, these smaller actors are generally subject to a much lighter regulatory regime. They do not need to be authorised in the same way as larger AIFMs and many of the provisions of AIFMD do not apply to them. It is unclear whether the EUSR rules are meant to apply to them at all. The ESAs have suggested clarification of this in the context of the ongoing AIFMD review, which seems like an appropriate approach to ensure coherence between the AIFMD and EUSR regimes.
- **Third country AIFMs:** This is an area that has always been difficult to interpret. On a very strict reading, any AIFM, wherever situated, would be in scope as soon as it managed or marketed a fund in the EU. Since the entity captured is the fund manager, it would, on a strict reading, "contaminate" all of the manager's funds in an open-ended way. This is clearly not a sensible reading, and the market has settled on an approach where only the fund(s) marketed or managed in the EU are affected. The ESAs have broadly endorsed this approach, which adds helpful certainty and have suggested clarifying the supervisory approach taken to ensure non-EU AIFMs are properly supervised by an authority in the EU in respect of these obligations. This seems like a straightforwardly helpful proposal.

STS RECOMMENDATIONS

The ESAs' recommendations in this area are not especially attention-grabbing. The Review Report goes through the data on the performance of the STS label and cautiously declares it a success, though it notes certain deficiencies that could be addressed. Chief among these is that the STS label has not had the hoped-for success in tempting new investors into the securitisation markets. The ESAs hypothesise that the reasons for this might include the diversity of investment products available in the market, easy monetary policy making securitisation less competitive and uncertainties about the jurisdictional scope of the due diligence requirements. While these factors are relevant, many market participants would argue that the onerous regulatory due diligence requirements applicable only to securitisation (and no competing investment products) are a more important factor than any of those proposed by the ESAs. It is very welcome, however, that the ESAs suggest that the prudential treatment of STS securitisation might also need a reassessment, although it should be noted this has not actually been carried out because it is beyond the scope of the report.

Beyond that, the ESAs' main findings on the STS system are as follows:

- More guidance and Q&As should be published on the STS criteria and compliance to help create a uniform market approach to the requirements and also to make things more transparent so more entities might consider being third party verifiers of STS status (TPVs) beyond the two currently authorised: PCS and SVI.
- On the non-ABCP STS criteria, they acknowledge some difficulties but say more time is needed to assess. The result is that no changes are

recommended for now but the ESAs would like to examine in future whether the STS criteria could be simplified without reducing the quality of the standard.

- On the ABCP STS criteria the ESAs take the curious approach of saying there are no STS ABCP programmes and that represents a problem – but also saying there's no particular need to make changes to address that until there's more of a business case for the STS label at programme level. This is confusing because the reasons they state for there being no strong business case for STS ABCP programmes are all regulatory in nature, and therefore must be within their control to make recommendations to fix.
- There is a somewhat unexpected suggestion that market participants are relying on TPVs too much and something should be done to emphasise that "securitising parties are under an ongoing obligation to check compliance with the STS requirements throughout the life of the securitisation".[10]
- As to supervision, the ESAs mention the possibility of delegating supervisory responsibilities from Member States with relatively little STS issuance either to those with more issuance (and therefore knowledge and experience) or to one of the ESAs.

THE ESA RECOMMENDATIONS IN CONTEXT

These recommendations are lengthy and detailed, but they also only represent one step in a wider process. The ESAs' recommendations largely suggest increased regulatory oversight, more onerous obligations on market participants and less openness to third country market participants in the EU.

The HLF Report and the CMU 2020 Action Plan, on the other hand, have broader scopes and suggest a move in the opposite direction. On crucial questions such as the approach to Article 5(1)(e), for example, the HLF Report is much more in line with industry sentiments, suggesting that the Commission should "[a]llow an EU-regulated investor in third-country securitisations to determine whether it has received sufficient information to meet the requirements of Article 5…to carry out its due diligence obligation proportionate to the risk profile of such securitisations"[11]. Similarly, the HLF Report invites the Commission (who pick up this recommendation in the CMU 2020 Action Plan) to "differentiate disclosure requirements for public securitisations and for private bilateral cash and synthetic securitisations"[12] – a recommendation broadly understood as suggesting a significant easing of disclosure obligations for private transactions, rather than the tightening suggested by the ESAs in their work.

Importantly, the wider scope of the HLF Report and CMU 2020 Action Plan include important industry priorities beyond the scope of the ESAs' mandated review, such as facilitating the SRT assessment process, recalibrating capital charges under both CRR and Solvency II, and upgrading the eligibility of senior STS and non-STS tranches in the LCR ratio.

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[10] Review Report, p. 62.
[11] HLF Report, p. 54.
[12] HLF Report, p. 54.

Pulling in the other direction is a political environment that remains somewhat sceptical in respect of securitisation – and perhaps regarding financial services more generally – that persists in the European Parliament and in some national capitals. This has been evident in the recent political processes surrounding the Capital Markets Recovery Package approved by the EU legislators, which saw a broadly sensible and helpful set of recommendations from the EBA on NPL securitisation and STS synthetics implemented into legislation that may yet cause more problems than it solves. The situation is similar with legislation meant to encourage a secondary market in NPLs. In that case, the imposition of strict licencing requirements, often unrealistic and potentially duplicative disclosure requirements and restrictions on credit purchasers' rights to recover on their debts makes clear to market professionals that the legislation is likely to discourage a secondary market in NPLs, not encourage it, notwithstanding its stated aims.

CONCLUSION

It remains difficult to predict the specific outcome of the EUSR review but at the moment the general direction of travel suggests some likely themes. More information is likely to have to be provided to regulators in a form that they anticipate will be convenient and helpful to both their general understanding of the market and their supervision efforts. It seems likely that markets will get clarification of the rules surrounding EU institutional investors investing in third country securitisations, though the direction of that clarity remains uncertain. Likewise, the persistent questions of the jurisdictional scope of the EUSR could well be addressed at long last, though the outcome of that exercise is unclear as is whether it will be helpful to the market. The STS criteria seem unlikely to be changed in the short term – at most there may be further level 3 guidance as to the meaning and practical application of those criteria. Reassessment of the prudential treatment (CRR, Solvency II, LCR, etc.) of securitisation seems to be on the cards, though it is unclear whether this will be restricted to STS securitisations or will also include the securitisation markets more generally.

As the endgame of implementing the EUSR is played out, the outcomes of most of the issues under consideration is essentially a political question, not a technocratic, administrative or legal one. Consequently, industry's engagement might be best focussed on educating and explaining as part of that political process – developing a simpler, more effective, and data-driven set of messages to communicate the value of securitisation to the broader economy, aimed at diminishing or eliminating the stigma that still surrounds securitisation nearly 15 years on from the 2008 financial crisis. Only by convincing regulators and policymakers of the benefits of securitisation – and that the risks it poses are now well-controlled – will it be possible for the EUSR review process to result in a better, more effective and proportionate regulatory framework. Sound technical arguments are not sufficient on their own to achieve industry's goals without official sector interlocutors being convinced that the industry's basic purpose contributes to the wealth and well-being of broader European society.

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