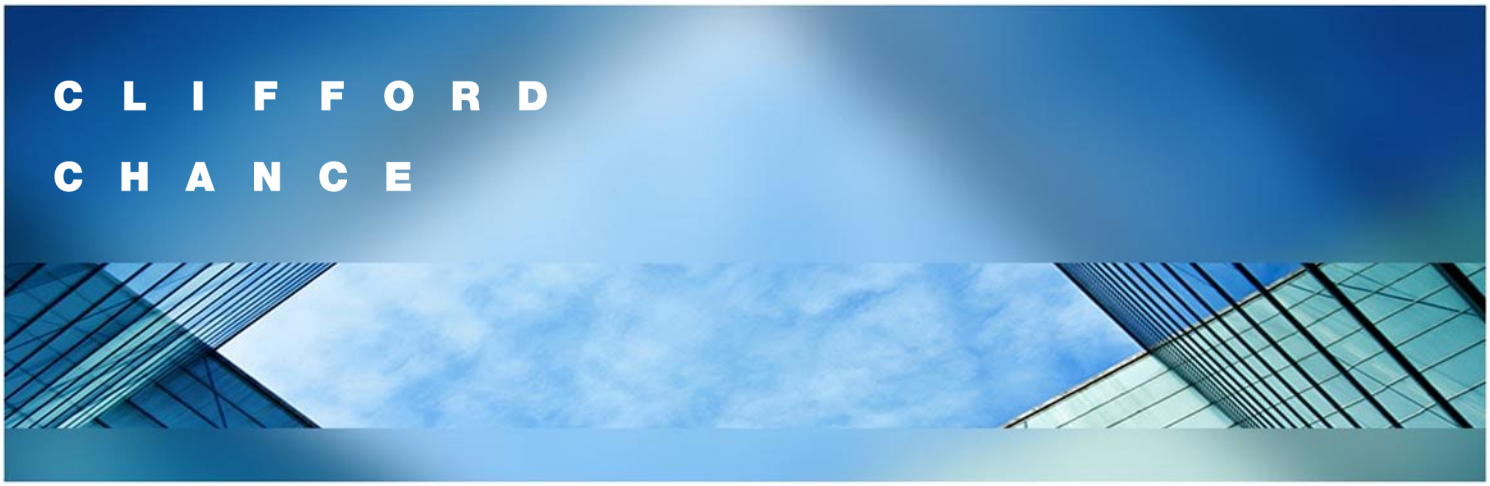

UK EDINBURGH REFORMS: THE NEW SECURITISATION FRAMEWORK?

The UK Government announced a package of proposed reforms to financial services regulation on 9 December 2022. The "Edinburgh Reforms" are intended to drive growth and competitiveness in the UK financial services sector. In this briefing we consider the specifics of the changes proposed to the securitisation regulatory framework.

The Edinburgh Reforms announced last week cover 43 core files, of which securitisation is just one. Reforming the regulation of securitisation in the UK falls into the first tranche for implementation, along with prospectuses and payments.

ILLUSTRATIVE SECURITISATION RULES

For each of the leading three areas, the Government published draft statutory instruments to give an indication of how the powers in the Financial Services and Markets Bill (the "**FSM Bill**") will be used. The FSM Bill, which will amend the Financial Services and Markets Act 2000 ("**FSMA**"), is currently working its way through the UK Parliament and would legislate for the UK Government's "Future Regulatory Framework". It provides for retained EU financial services law to be revoked and replaced by "homemade" UK law, such as statutory instruments made by HM Treasury, the Financial Conduct Authority (the "**FCA**") Handbook and the Prudential Regulation Authority (the "**PRA**") Rulebook (together the "**Rulebooks**"). It also creates a new "designated activities regime" (the "**DAR**") which allows the FCA to make rules that bind anyone (including those it does not authorise) who engages in certain financial markets activity.

HOW DOES THE DRAFT SI WORK?

The draft statutory instrument for securitisation (the "**Draft SI**") is intended to be paired with the revocation of existing EU-derived securitisation rules and also with forthcoming amendments to the Rulebooks. The FSM Bill and Draft SI:

- Grant powers to the FCA and PRA to make securitisation-related rules - including by making certain sell-side activities in securitisation "designated activities". This means most of the day-to-day substantive rules applicable to market participants from the previously applicable retained EU law on securitisation will move to the Rulebooks.

Key issues

- The Financial Services and Markets Bill, once enacted, will provide for EU retained financial services law to be "lifted and shifted" into more traditional forms of UK law
- The Government's announcement on 9 December provided more detail on the planned reforms including three illustrative draft statutory instruments
- As expected, the securitisation Draft SI mainly creates a framework for the FCA and PRA to make substantive securitisation rules, which we have not yet seen
- The FCA and PRA will be guided as to policy changes by the Government's December 2021 review of the Securitisation Regulation
- Certain areas, such as due diligence obligations for occupational pension schemes, are provided for directly in the draft SI
- Much of the SI is given over to providing for the "infrastructure" of the securitisation markets, including the authorisation and regulation of securitisation repositories and third party verifiers

- Give directions to the FCA and PRA about how to regulate securitisation (including both firm and systemic financial stability considerations) and instruct them to have regard to the "coherence of the overall framework for the regulation of securitisation" when making rules applicable to firms.
- Grant powers to the FCA to dispense with its rules in some circumstances, which looks like it may be providing for something similar to the US "no action" letter regime. The lack of flexibility in the EU has caused issues, so UK movement in that direction would be a welcome development.
- Provide detail on the equivalence regime for allowing UK institutional investors to treat non-UK securitisations as simple, transparent and standardised, or "STS". These include requirements for any equivalent country to have law and practice with equivalent effect and to have cooperation arrangements in place with UK regulators.
- Move some provisions of existing EU law into the Draft SI itself, including the frameworks for authorising and regulating securitisation repositories and third party verifiers of STS.

WHAT ABOUT THE SUBSTANTIVE RULES FOR FIRMS?

Broadly, the intention seems to be that the regulatory perimeter (i.e. who is regulated) should stay as it is, except that certain non-UK fund managers who offer their funds into the UK should be excluded.

Because the rules will be written by the regulators, we don't have the detail on those, but it is worth noting that the Policy Note accompanying the Draft SI makes clear the FCA and PRA should implement the securitisation policy changes HM Treasury identified in its December 2021 review. These include:

- revising the disclosure requirements and, in particular, the public/private distinction in order to provide more flexibility for private deals
- reviewing risk retention arrangements to provide more flexibility, especially for CLOs and non-performing loan deals
- reviewing the due diligence rules, especially as concerns what information UK investors need in order to invest in non-UK deals

Sell-side obligations

The PRA (in respect of credit institutions and large investment firms) and FCA (in respect of everyone else) will write the rules for sell-side firms by moving the relevant rules to the Rulebooks. Regulation 40 of the Draft SI specifies "acting as the originator, sponsor, original lender or securitisation special purpose entity in a securitisation" as a designated activity for the purposes of the DAR, giving the FCA powers to make rules for anyone who is not a PRA-authorised firm. As a result, all sell side market participants would be caught by detailed rules on securitisations contained in the Rulebooks. As to substance, we will have to wait to see the drafts the regulators produce, probably in 2023.

Buy-side obligations

On the buy side, the regulatory structure is broadly similar, with the PRA regulating credit institutions and larger investment firms and the FCA regulating most others. Things are complicated slightly by the fact that (a) only "institutional investors" (and not all investors) are in-scope; (b) institutional investors should be regulated by their existing regulators rather than a specific securitisation regulator; and (c) institutional investors have different regulatory arrangements; and (d) only the FCA and PRA have rule-making powers under FSMA.

The end result is that the FCA and PRA will make due diligence rules for most institutional investors, but the rules applicable to occupational pension schemes appear directly in the Draft SI since they are supervised by the Pensions Regulator (the "**TPR**") who do not have any FSMA rule-making powers. The Draft SI largely maintains the currently applicable requirements of article 5 of the UK Securitisation Regulation, without amendment in line with the December 2021 review. This is surprising, given it identified clarifying due diligence rules in relation to non-UK investments as a priority. Assuming that is still policy, the Draft SI would risk creating substantively different due diligence requirements for occupational pension schemes vis-a-vis other institutional investors unless HM Treasury amends it each time the regulators update the Rulebooks.

WHAT NEXT?

The Draft SI is illustrative only. It remains subject to change and in some places still contains notes about what policy is intended to be rather than legislative drafting. So while it is extremely useful as a tool for understanding the Government's current thinking, it is not by any means final.

Before the Draft SI can become law, the FSM Bill will need to clear Parliament, which may not happen before the end of 2022. Since the Draft SI makes provision for the FCA and PRA to replace an existing body of EU retained law, it also seems unlikely it will be made law before the regulators have consulted on and finalised their replacement rules. In that context, the Government's guidance as to timing doesn't really add much, since it just says "it is expected [the securitisation reforms] will come into force in 2023 at the earliest".

We understand that the FCA and the PRA are likely to begin consultations on their detailed reforms of the substantive rules applicable to firms within the next few months. This will provide further insight as to the extent to which the proposed reforms to securitisation regulation in the UK will, in the words of the Chancellor of the Exchequer, "reshape our regulatory regime and unleash the full potential of our formidable financial sector" and therefore achieve the stated principles of the Edinburgh Reforms. Until then, it is hard to know how "new" the securitisation framework will really be,

Finally, it is worth bearing in mind that opposition parties have been extremely critical of the Edinburgh Reforms generally, meaning some aspects of them may be reversed following the next election. The changes to the securitisation rules are sufficiently incremental and technical that seem likely to escape the worst of the political tug of war, but that is not guaranteed.

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