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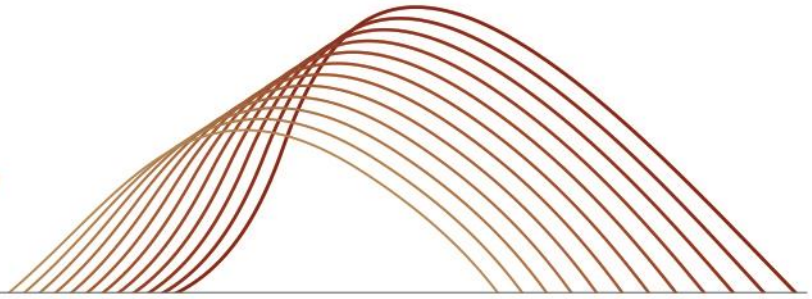

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FCA/PRA, UK Government and ESMA release new requirements for Securitisation Regulation

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In a flurry of activity leading up to the holiday break, the FCA and PRA, the UK Government and ESMA have all released a series of new guidance, announcements and requirements that will apply under the new Securitisation Regulation which comes into force on 1 January 2019. These include a new reporting template for private transactions that was published by the FCA/PRA, new draft reporting templates from ESMA and a draft UK statutory instrument to transpose the Securitisation Regulation into UK law after Brexit.

Background

The provisions of the Securitisation Regulation[1] apply to any securitisation that is issued from 1 January 2019 (including CLOs and CLO warehouses and fund leverage deals that are structured as securitisations). Many areas of the Securitisation Regulation and the related guidance remain unfinished business, with market participants hoping for clarity on a number of important areas.

In the last 48 hours some of these areas have been clarified. But in some cases the authorities have announced new requirements, which may themselves create even more uncertainty. This note summarises these latest developments. As ever, we remain committed to help our clients navigate this changing regulatory landscape. Please do get in touch with your Paul Hastings contact.

Reporting Obligations and Private Transactions

Article 7 of the Securitisation Regulation requires disclosure of quarterly portfolio level disclosure, quarterly deal level information, any inside information relating to the securitisation that the reporting entity is obliged to make public under the Market Abuse Regulation and any significant events. In addition, the rule requires certain information to be made available "prior to pricing", including final form transaction documents and a transaction summary.

On 22 August 2018 ESMA published its final report on the reporting obligations under Article 7 of the Securitisation Regulation (the "**ESMA Transparency Report**"). The terms of the ESMA Transparency Report specified that the reporting obligations under Article 7 of the Securitisation Regulation should apply to "private" transactions, which are defined as transactions which do not have a prospectus drawn up in compliance with the Prospectus Directive.[2] This position was counter to an earlier version of the report that formed the basis of the ESMA Transparency Report,

[1] Regulation (EU) 2017/2402
[2] Directive (EU) 2003/71/EC

and industry argued that private transactions should not be subject to the reporting obligations under Article 7 of the Securitisation Regulation.

In a note to industry bodies on 19 December 2018, ESMA re-iterated its position that the reporting obligations should indeed apply to "private transactions". And in a Q&A statement that accompanied the note, ESMA went on to clarify which templates apply to public or private transactions. As it applies to CLOs, ESMA has clarified that the loan level template (Annex 4) and investor report template (Annex 12) would apply, but the inside information template (Annex 15) and significant event template (Annex 16) would not.

While this position is disappointing, it is helpful to have further confirmation of which templates apply. With respect to Annex 15 and Annex 16, it is important to note that even though the templates do not apply to private transactions, the related primary obligation to disclose inside information and significant events in accordance with Article 7(1)(f) and (g) do apply to private transactions.

A NEW Template from the FCA and PRA for Private Transactions

Article 7 of the Securitisation Regulation requires that the required information is made available to competent authorities. Where a transaction is public (again, which is defined as a transaction where a prospectus is drawn up in compliance with the Prospectus Directive) this is done by disclosing the information on a securitisation repository. But the Securitisation Regulation does not provide any facility for making the information available to competent authorities for private transactions.

In a joint statement of the PRA and FCA on 20 December 2018, the PRA and FCA have required that a summary of the transaction be notified to the relevant UK authority in accordance with a new template. Any further information required under Article 7 of the Securitisation Regulation can be made available (upon request). This requirement will apply to any issuance after 1 January 2019 (with effect from 15 January 2019) where at least one of the originator, sponsor or SSPE are located in the UK, and will be required (i) upon issuance and (ii) upon each date that any inside information or significant event is disclosed in accordance with Article 7(1)(f) and (g) of the Securitisation Regulation.

The new template (click here), called the "PRA/FCA – Private Securitisation Notification Template", has 18 fields including information regarding the parties involved, the asset class of the transaction and contact information. The notification is required to be sent to the PRA or FCA (as applicable) at specified email addresses.

More or Less "No Data"?

On 18 December 2019 ESMA published a letter it had received from the EU Commission where the EU Commission had requested that ESMA expand the use of the "No Data" option in the loan level reporting templates in the ESMA Transparency Report.

This was welcome news to the CLO industry that had hoped that the loan level reporting obligations would be significantly relaxed.

But on 19 December 2018, in a note to industry bodies, ESMA reported that it had received limited industry requests to expand the No Data concept (other than in the context of ABCP transactions). Instead, ESMA noted that the majority of industry feedback related to the context of the fields and requests for guidance on the scope or nuances of the fields.

On that basis, ESMA has published a revised set of draft reporting templates. Unfortunately, the loan level reporting template that applies to CLOs (Annex 4) has only four new No Data options

(out of 121 fields), and little change has been made to the fields themselves. In addition, the investor report (Annex 12) has no new No Data options.

ESMA now has a period of six weeks to publish the final ESMA Transparency Report, with the revised templates. On the basis that there will be limited scope for further comment, it is not expected that the reporting templates will be further revised in any meaningful way.

Transition Period?

In the ESMA Transparency Report of 22 August 2018, ESMA recommended a transition period of between 15 to 18 months. But in its note to industry bodies on 19 December 2018, ESMA implied that such a formal transition period is now unlikely to be granted. This was on the basis of several factors, but principally the statement of 30 November from the ESAs regarding the application of the CRA3 reporting templates (see our note, here).

On this basis, we expect that from 1 January 2019 until the ESMA templates are adopted (which is likely to be 4-6 months into 2019) transactions will continue to report the loan level and deal level information in accordance with the current CLO payment date report infrastructure.

Third Country Sponsor?

The definition of sponsor in the Securitisation Regulation refers to an investment firm, as defined in MiFID II (2014/65/EU) ("MiFID II").

Securitisation Regulation - Article 2(5) –

'sponsor' means a credit institution, whether located in the Union or not, as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013, or an investment firm as defined in point (1) of Article 4(1) of Directive 2014/65/EU other than an originator, that (a) establishes and manages an asset-backed commercial paper programme or other securitisation…

MiFID II – Article 4(1)(1) –

'investment firm' means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.

The CLO market had noted that the definition of investment firm in MiFID II did not itself make reference to the jurisdiction of the entity nor to the authorisation status of the entity. On that basis, it was argued by many that the new definition of sponsor was wider than the definition in the current regime which requires that the entity have particular authorisation status under MiFID. In order to achieve that status, they would have to be domiciled in an EU Member State.

In early October 2018 the EBA received a question on this topic through its online Q&A facility. The question sought to confirm the above analysis. The EBA has yet to provide a response to the question, and it is now expected to only do so in the new year.

But on 19 December 2018 the UK Government published a draft statutory instrument with respect to the Securitisation Regulation as it will apply following Brexit (the "**Statutory Instrument**") (click here). Upon Brexit, all existing EU law will become UK law. This draft statutory instrument proposes to make certain amendments to the Securitisation Regulation in order to allow for the proper functioning of the regulation once it becomes UK law.

The draft statutory instrument has a number of amendments, but interestingly amends the definition of sponsor as below.

"(5) 'sponsor' means a credit institution as defined in point (1) of Article 4(1) of Regulation (EU) No 575/2013 or an investment firm as defined in paragraph 1A of Article 2 of Regulation 600/2014/EU, whether located in the United Kingdom or in a third country, which—…"

It is interesting to note that the qualification regarding the jurisdiction of the entity has been moved so that it applies to both credit institutions and investment firms. This seems to suggest that the UK Government considers that the sponsor concept should include entities from outside the UK, and that it was necessary to amend the drafting to reflect this intention.

While this is in draft form and would not (even once adopted) apply to EU entities, it is perhaps indicative of how the EBA may respond to the Q&A. On this basis we consider it is likely that the EBA will establish that the sponsor concept may include investment firms that are not domiciled in the EU.

This would be a welcome clarification and should remove any uncertainty and debate going forward. For transactions that close from 1 January 2019 managers would be able to satisfy the risk retention rules as a sponsor, regardless of their jurisdiction. This is particularly helpful for the CLO industry for the following reasons:

1. US CLOs – Managers of US CLOs would be able to satisfy the risk retention and reporting requirements as a sponsor. Past practice has mostly followed the "originator/manager" structure, which should now largely become obsolete. This means that managers will not have to "season" loans on their balance sheet prior to the securitisation.

2. Brexit – UK based managers would be able to satisfy the risk retention and reporting requirements as a sponsor, regardless of the outcome of Brexit and any transition period. Transactions structured in this manner should be insulated from Brexit with respect to risk retention and reporting.

3. Authorisation status – the current regime requires that a manager must have certain authorisations in order to qualify as a sponsor. In some cases these authorisations may cause additional and burdensome obligations and requirements to which the manager would not otherwise be subject. With the new regime, managers would be able to comply with the risk retention and reporting obligations but will be free, at least as it relates to the risk retention and reporting obligations, to amend their authorisation status in order to alleviate some of these additional or burdensome obligations.

It should be noted that managers of legacy transactions where the manager has acted as a sponsor would not be able to avail themselves of the wider definition. The Securitisation Regulation provides that for legacy transactions (those closed after 2011 but before January 2010), the provisions of Article 405 of the CRR (and similar provisions in AIFMD and Solvency II) will continue to apply. This means the current rules will continue to apply to legacy transactions after the coming into force of the Securitisation Regulation (January 2019). In the context of legacy transactions where the retention is held by a sponsor, until the transaction is terminated or reset the sponsor will continue to be required to fall within the definition of CRR investment firm (and thus the current more stringent regime).

US CLOs and Reporting

One of the outstanding questions facing the CLO market is whether the reporting obligations of Article 7 to the Securitisation Regulation apply to CLOs where none of the issuer, originator or sponsor is located in the EU. This would usually be the case in a US CLO. Nothing in the Securitisation Regulation provides for any direct obligation.

However, the CLO industry has noted that where an EU institutional investor intends to invest in a securitisation it must, in accordance with Article 5(1)(e) of the Securitisation Regulation, verify that the originator, sponsor or issuer has, where applicable, made available the information required by Article 7….". It has been noted that one could argue that the reference to "where applicable" refers to whether or not the rule applies to the originator, sponsor or issuer directly. It has also been noted that the similar diligence requirement for risk retention clearly provides that an EU investor is still required to verify the risk retention obligation even where none of the sponsor or originator is located in the EU. This is not the case with respect to reporting. On this basis, one could argue that where no entity is located in the EU, the investor is not required to verify the reporting obligation.

In the draft Statutory Instrument published on 19 December 2018, the UK Government has proposed to amend the equivalent provisions in what would be (post Brexit) the UK Securitisation Regulation. The UK Government has amended paragraph 5(1)(e) to specify that it only applies where the relevant entity is established in the UK, but has also included a new paragraph which provides that if none of the originator, sponsor or issuer are located in the UK, then the investor must verify that one has "*made available information which is substantially the same as that which it would have made available in accordance with point (e) [Article 7] if it had been established in the United Kingdom.*"

This suggests that the UK Government considers that it is necessary to clarify the scope of the application of the reporting obligations (post Brexit). Again, this may be a useful fact to help in the interpretation of Article 5(1)(e) of the Securitisation Regulation, and whether investors in US CLOs are required to ensure compliance. Of course this will not be determinative with respect to the interpretation of the EU provision, and ultimately the outcome of this requirement may depend on how conservative (or not) EU investors are when they invest in US CLOs post 1 January 2019.

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If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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