The new European rules for securitisations

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The EU has enacted a new set of regulations applicable to securitisations, and a more specific framework for simple, transparent, and standardised securitisations ("the regulation"). A securitisation is any transaction or scheme that tranches the credit risk associated with an exposure or pool of exposures. Payments in the transaction are dependent upon the performance of the exposure or of the pool of exposures and the subordination of tranches determines the distribution of losses. The regulation is the next building block in the ambitious capital market union (CMU) project and is directly applicable without transposition into national legislation of the EU member states beginning as of 1 January 2019.

Executive summary

The new EU rules on securitisations will enter into force on 1 January 2019 and will affect originators, sponsors, original lenders, special purpose vehicles, institutional investors and anyone selling securitisations to retail investors without differentiation whether domiciled in the EU or in a third country such as Switzerland. There are general rules applicable to all securitisations. Other rules are only applicable to certain categories of securitisations called simple, transparent and standardised securitisations, and the sub-category asset backed commercial paper securitisations. Non-compliance with the rules can be sanctioned with fines of up to EUR 5m. or 10% of the total annual net turnover.

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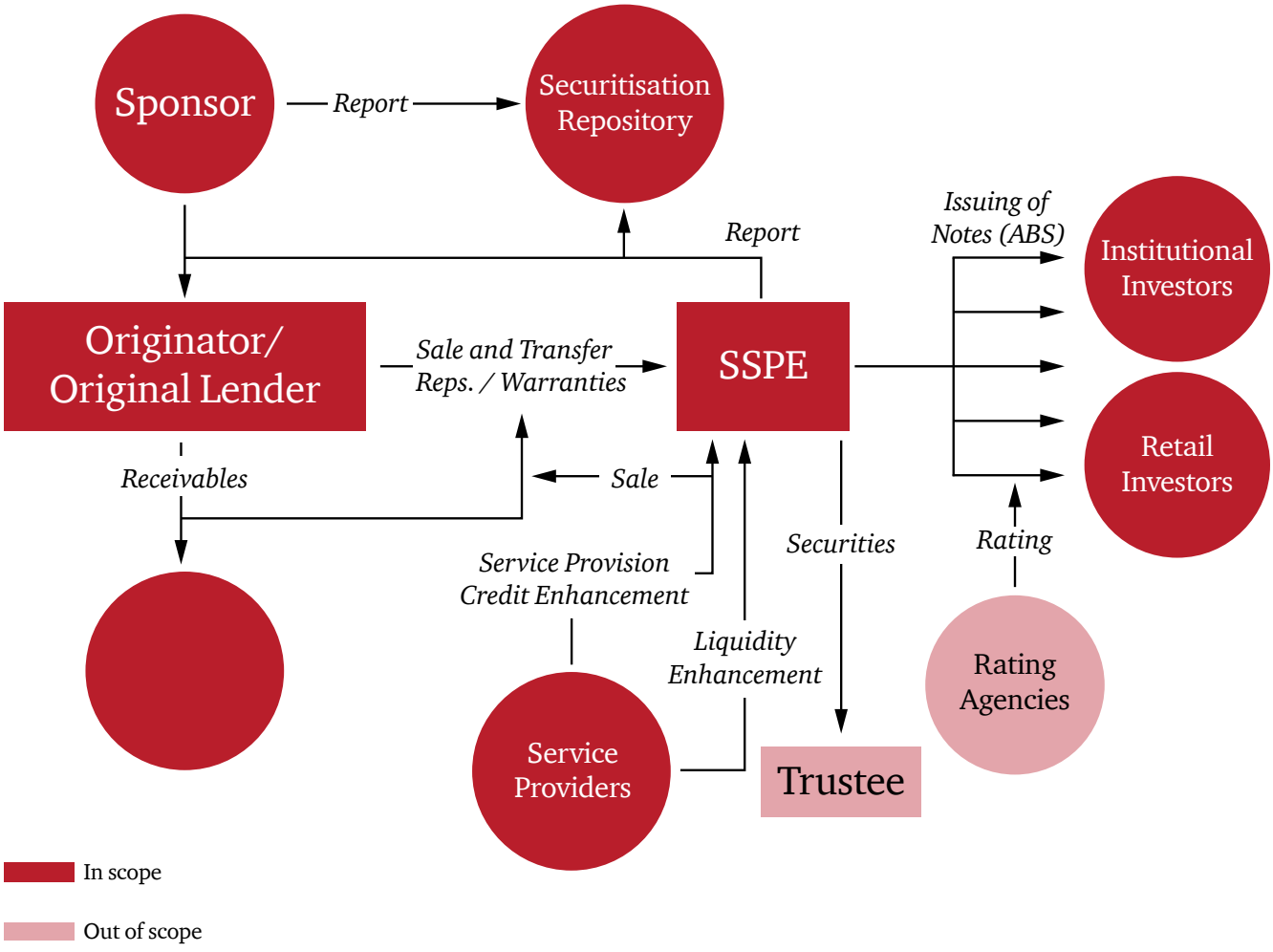
1. What is the scope of the new rules on securitisations?

The regulation applies to EU regulated institutional investors as well as to originators, sponsors, original lenders and securitisation special purpose entities no matter whether they are domiciled in the EU or in a third country, such as Switzerland (Art. 1 para. 2). The regulation acknowledges the importance of securitisations in capital markets but imposes restrictions on the key stakeholders involved in a securitisation to ensure the soundness and sustainability of the securitisation. The key stakeholders involved in a securitisation subject to the new rules under the regulation are (see definitions in Art. 2):



- ABCP; asset backed commercial paper which are securities having an original maturity of one year or less
- Institutional investors; insurance or reinsurance undertakings, AIFM, UCITS, internally managed UCITS, or credit institutions regulated under the corresponding EU-financial market legislation
- Investors; a natural or legal person holding a securitisation position
- Original lenders; the entity that concluded the initial agreement which created the obligations or potential obligations of the debtor giving rise to the exposure being securitised
- Originators; an entity which was involved in the original agreement that created the obligations or potential obligations of the debtor
- Retail investors; an investor as defined in point 11 of Art. 4 para. 1 MiFID II
- Servicers; an entity that manages a pool of purchased receivables or the underlying credit exposures on a day-to-day basis
- Sponsors: any EU or third-country credit institution that establishes or manages a securitisation that purchases exposures form third-party entities
- Securitisation repositories; a legal entity duly licensed that collects and maintains the records of securitisations
- SSPE; a securitisation special purpose entity, being a corporation, trust or other entity other than the originator or sponsor established for the purpose of carrying out one or more securitisations.

2. What categories of securitisations exist and what are the related obligations?

The regulation introduces new obligations and different categories of securitisations. Certain obligations under the regulation, such as sales restrictions applicable to retail investors, apply to all sellers of securitisations. There are also obligations that apply to all categories of securitisations. Other obligations apply only to certain categories of securitisations, such as STS securitisations, which fulfil the simple, transparent, and standardised requirements of an STS securitisation. A subcategory within the STS securitisations which is subject to even more extensive requirements is STS-ABCP securitisations, meaning simple, standardised, and transparent asset backed commercial paper having an original maturity of one year or less.

3. What are the selling restrictions applicable to retail investors?

There are basic restrictions applicable to anyone selling securitisations to retail investors. A securitisation position can only be sold to a retail investor if a suitability test has been performed and communicated and the securitisation position is suitable for the client. A portfolio of a retail investor not exceeding EUR 500,000 in aggregate may not have more than 10% of the retail investor's financial instruments in securitisation positions which must reach at least EUR 10,000 (Art. 3).

4. Which obligations are applicable to all securitisations?

a. Obligations applicable to institutional investors
The regulation allocates an important gatekeeper function to institutional investors due to their sophistication. They have to engage in extensive due diligence exercises when entering into a securitisation position. They have, in particular, to ensure that:

- The originator and orginal Llender grants all the credits on the basis of sound and well-defined criteria and established processes, unless it is a credit institution or investment firm established in the Union (Art. 5 para. 1 lit. a and b)
- The originator, sponsor or original lender retains on an ongoing basis a material net economic interest (at least 5% when established in a third country) (Art. 5 para. 1 lit. c and d)
- The originator, sponsor, original lender or SSPE makes information available in the required frequency and format (Art. 5 para. 1 lit. e)
- A due-diligence assessment is carried out which enables assessment of the risks involved (Art. 5 para. 3)
- Appropriate written procedures proportionate to the risk profile are established, regular stress tests are performed, internal reporting to the management body is made, and a thorough understanding of the credit quality of the sponsor and the terms of the facility is achieved (Art. 5 para. 4).

b. Obligations of the originator, sponsor, or original lender
Originators, sponsors, or 0riginal lenders have to keep a material net economomic interest in the securitisation of not less than 5% on an ongoing basis (Art. 6 para. 1 and 3). They have to apply to exposures to be securitised the same sound and well-defined criteria for credit-granting which they apply to non-securitised exposures (Art. 9). Securitisations should not be used to get rid of loans in default. Originators shall thus not select assets to be transferred to the SSPE with the aim of transferring losses on the assets to the SSPE (Art. 6 para. 2).

c. Obligations of the originator, sponsor, and SSPE
The originator, sponsor, or SSPE makes at least the following information available to holders of a securitisation position, to the competent authorities, and upon request to potential investors by means of a securitisation repository:

• Information on the underlying exposures on a quarterly basis or in the case of an ABCP information on the underlying receivables or credit claims on a monthly basis (Art. 7 para. 1 lit. a and e)

• All underlying documentation that is essential for the understanding of the transaction (Art. 7 para. 2 lit. b)

• A transaction summary or overview of the main features of securitisation where a prospectus has not been drawn up (Art. 7 para. 1 lit. c)

• The STS notification (if an STS securitisation) (Art. 7 para. 1 lit. d)

• Any inside information that must be made public (Art. 7 para. 1 lit. f) or if not applicable any significant event (Art. 7 para. 1 lit. g).

d. Prohibition of resecuritisation
Resecuritisations or CDO2 have been very prominent in the run-up to the latest financial crisis. Resecuritisations or CDO2 where at least one of the underlying exposures is a securitisation position are not permitted under the regulation (Art. 8) due to the inherent risks. However, the ban does not apply to any securitisation the securities of which were issued prior to the 1 January 2019 and certain other legally defined exemptions.

5. What are simple, transparent and standardised securitisations?

The regulation allows for the possibility that originators, sponsors and SSPEs may use the designation "STS" or "simple, transparent, and standardised" if all of them are established in the Union and the securitisations meet the requirements of an STS securitisation (Art. 18). Originators and sponsors have to jointly notify the ESMA when a securitisation meets the requirements of an STS securitisation. The notification will then be published on the ESMA webpage (Art. 27 para. 1 et 2). The requirements differ between non-ABCP securitisations and ABCP-securitisations.

a. Requirements for simple, transparent and standardised non-ABCP securitisation

There are specific requirements that must be met for a non-ABCP securitisation to qualify as an STS securitisation. These requirements and obligations go beyond what is generally required for any securitisation. One of the key elements is the unconditional and unencumbered transfer of ownership to an homogenous pool of assets from the SSPE and the prohibition of the "originate to distribute-model", meaning that loans are only entered into in the first place to then be sold off for repackaging. The transferred assets cannot be in default and must have made at least one payment (Art. 20). Interest rate and currency risks arising from the securitisation should be appropriately mitigated, and enforcement and acceleration notices must be disclosed in combination with the contractual obligations, duties and responsibilities (Art. 21). The originator and sponsor must also make available statistical data and liability cash flow models (Art. 22).

b. Requirements for simple, transparent and standardised ABCP securitisation

STS securitisations in the form of ABCP securitisations are subject to certain requirements at the transaction level, which are very similar to the requirements for an STS securitisation which is a non-ABCP securitisation. There are also quantitative, hedging, and documentary requirements applicable at the ABCP programme level. These requirements typically take an aggregate view of the transactions (Art. 26). The sponsor of an ABCP programme must be a credit insitution domiciled in the Union (Art. 25). It must perform its own due diligence and is responsible for making the required information available to potential investors.

6. What are the sanctions for non-compliance?

Non-compliance with the rules applicable to securitisations can in the case of natural and legal persons amount to a maximum administrative pecuniary sanction of at least EUR 5m. or up to 10% of the total annual net turnover of a legal person (Art. 32 para. 2).

7. How are Swiss domiciled entities active in the securitisation market affected by the new EU regulations?

The regulation has an extraterritorial reach and applies to Swiss entities active in securitisations even without directly stating so. Affected are originators, sponsors, original lenders and servicers domiciled in Switzerland if a securitisation has a connection to the EU. Such a connection is, for example, given whenever securitisations are sold to retail investors or to an institutional investor performing a due diligence on the securitisation. Securitisations should generally not be sold to retail investors, unless suitable (introductory chiffre 15 in the regulation). Institutional investors will only be in a position to perform a due diligence on the securitisation successfully if the securitisation is compliant with all the requirements applicable to a securitisation. This means that a securitisation must be compliant with the requirements under the regulation if it is to be sold to EU based institutional investors. There are additional situations to which the regulation will apply. Therefore a careful evaluation of the applicability of the regulation to the activities of Swiss domiciled entities being part of the securitisation value chain is required.

The regulation explicitly requires, however, that the originator, sponsor, and SSPE involved in a securitisation considered an STS securitisation must be established in the Union. An SSPE can only be established in non-EU jurisdictions which are compliant with FATF requirements.

8. When will the new rules enter into force?

The new EU rules applicable to securitisations will enter into force on 1 January 2019 and apply to securitisations the securities of which are issued on or after 1 January 2019 assuming that the corresponding RTS will not enter into force later (Art. 43). However, the STS securitisation label can already be used for securitisations that have been issued earlier than 1 January 2019 if they meet the STS requirements (Art. 43 para. 2 et seq.).