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# European Commission presents report to the European Parliament and Council on the functioning of the EU Securitisation Regulation

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**Executive Summary**

- The Commission has published its review of the EU Securitisation Regulation.
- The review specified that EU investors should only invest in securitisations which comply with Articles 6 (Risk Retention), 7 (Transparency) and 9 (Credit Granting) of the EU Securitisation Regulation. This effectively means the Commission is of the view that EU investors must verify that a non-EU Securitisation complies with the full transparency and information requirements of Article 7 (see "*Jurisdictional Scope: Is this the end of EU-Lite Transactions? – Sell-side Obligations*").
- The Commission provided certain interpretative clarifications on scope regarding non-EU AIFMs operating within the EU and compliance with the EU Securitisation Regulation (see "*Jurisdictional Scope: Is this the end of EU-Lite Transactions? – AIFM Investors*").
- ESMA has been invited to review and adjust the asset level reporting templates under Article 7 and to consider the creation of a simplified template for the reporting of private securitisations with a focus on information for supervisors (see "*Due Diligence and Transparency*" and "*Private Securitisations*").
- The Commission determined that no STS equivalence regime will be introduced at this point

in time, including in respect of UK STS securitisations (see "*STS Equivalence*").

- The EBA report suggestions to include a sustainable securitisation framework within broader EU Green Bond Standards rather than as a separate framework and to provide for principal adverse sustainability impact disclosures for all securitisations was accepted by the Commission (see "*Sustainable Securitisations*").

- The risk retention requirements remain unchanged, though the Commission may examine the use and efficacy of particular retention methods (see "*Risk Retention*").

## Background

On 10 October 2022, the European Commission (the "**Commission**") published its report (the "**Report**")[1] to the European Parliament and Council on the functioning of Regulation (EU) 2017/2402 (the "**EU Securitisation Regulation**") as required pursuant to Article 46 of the EU Securitisation Regulation.

The Report comes more than three years after the entry into application of the EU Securitisation Regulation and covers a broad range of issues taking into account issues raised by the European Supervisory Authorities (the "**ESAs**")[2], an opinion given by the Joint Committee of the ESAs (the "**JCO**")[3] and a public consultation undertaken by the Commission in preparation for this report (the "**Consultation**"). Please note that following the UK's departure from the European Union this report has no effect on the EU Securitisation Regulation as implemented in the UK.[4]

As a general matter, the Commission stated that it does not see the need for major legislative change at this stage, it has acknowledged there is room for "fine-tuning" in some cases, and has sought to clarify certain aspects of the EU Securitisation Regulation that until now were the subject of some market uncertainty.

The most significant aspect of the Report is the Commission's interpretation of the jurisdictional scope of the EU Securitisation Regulation, in particular, the Commission directly addressed the applicability of Article 7 of the EU Securitisation Regulation ("**Article 7**") and specifically whether EU institutional investors in securitisations issued outside the EU (i.e., where none of the originator, sponsor, original lender or "securitisation special purpose entity" or "**SSPE**" are established in the European Union ("**non-EU Securitisations**")) are required to receive all of the information specified in Article 7 in order to fulfil their due diligence requirements as set out in Article 5(1)(e) of the EU Securitisation Regulation ("**Article 5**"). As discussed below, this clarification will have a significant impact on non-EU Securitisations which are sold to EU institutional investors.

## Jurisdictional Scope: Is this the end of EU-Lite Transactions?

For a number of years, the jurisdictional scope of many of the obligations in the EU Securitisation Regulation have remained unclear. In 2021 the ESAs issued the JCO, considering among other things the jurisdictional scope of the EU Securitisation Regulation, which the Commission has considered in detail.[5]

*Sell-side obligations*

There has been some uncertainty in regards to the direct applicability of Articles 6 (Risk Retention), 7

(Transparency) and 9 (Credit Granting) of the EU Securitisation Regulation to non-EU Securitisations. This has resulted in a number of differing interpretations as to whether some or all of these Articles apply to non-EU Securitisations. Many non-EU Securitisations include a covenant to hold risk retention in accordance with Article 6 (Risk Retention) but specifically provide that the securitisation will not comply with the information and reporting requirements of Article 7 ("**EU-Lite Securitisations**"). The ESAs in the JCO made a number of recommendations to address these issues.

While the Commission did not accept some of the more controversial recommendations of the ESAs, particularly, the recommendation that one of the originator, sponsor, original lender or SSPE ("**Sell Side Parties**") must be located in the EU in order for EU competent authorities to enforce the obligations of such parties under the EU Securitisation Regulation, it did clarify the scope of Article 7 and Article 5(1)(e).

*Investor Due Diligence Requirements: Can EU Investors invest in EU-Lite Securitisations*

The Report's most impactful statements apply in the context of EU institutional investors investing in non-EU Securitisations.

The Commission specifically referenced the uncertainty around whether EU investors must confirm that the information provided in a non-EU Securitisation complies with the requirements of Article 7 and the related regulatory technical standards regarding Article 7. This would include pre-pricing disclosures, quarterly asset and transaction reporting using the prescribed ESMA templates and event reporting.

While the Commission acknowledged that there have been differing interpretations of Article 5(1)(e), the Commission made it clear that EU investors investing in non-EU Securitisations must ensure that the Sell Side Parties agree to comply with all aspects of the EU Securitisation Regulation prior to investing. The effect of this interpretative guidance is that EU institutional investors may not invest in non-EU Securitisations which do not comply with all the requirements of Article 7.

The Commission stated that the legislative intent was not to create a different scope of information to be provided depending on whether the securitisation is issued by an EU entity or an entity based in a third country, since this fact in itself should not impact the proper performance of diligence by those investors. As such, the Commission's interpretation is that in order for an EU institutional investor to invest in a non-EU Securitisation, the pre-pricing disclosures and on-going reporting requirements of Article 7 must be complied with in their entirety. This would include reporting of transaction and loan level information using the templates prescribed under the EU Securitisation Regulation and the European Securities and Markets Authority ("**ESMA**") reporting templates.

In order for a securitisation to satisfy the requirements of Article 7 a number of requirements need to be complied with at the securitisation level including, broadly, to provide to investors:

- a transaction summary (certain offering memorandums will largely satisfy this requirement) and the underlying transaction documentation essential for understanding the transaction;
- quarterly asset level reporting and investor level reporting completed in the relevant specific template format; and
- reporting without delay on an ad hoc basis, "significant events".

For further information on the detail of the transparency reporting requirements, please see our Clients & Friends memorandum “EU Securitisation Regulation Disclosure Templates Published in the EU Official Journal” published on 3 September 2020.[6]

Market participants should note that the Report is the Commission’s interpretation of the current legal framework. The Commission sets the policy and legislative agenda for the European Union and its statements and guidance hold significant weight in the interpretation of the EU Securitisation Regulation. It is certain that the ESAs and EU competent authorities will follow any guidance or statements issued by the Commission. As such EU investors need to consider very carefully any interpretation and guidance provided by the Commission.

*AIFM Investors*

The Commission also sought to clarify the position regarding alternative investment fund managers (“**AIFMs**”) as EU institutional investors in securitisations, in particular as to whether non-EU AIFMs managing or marketing an alternative investment fund (“**AIF**”) in the EU and certain smaller “sub-threshold” AIFMs would be covered by the EU Securitisation Regulation as EU institutional investors.

The Commission clarified that the AIFMs marketing and managing funds in the EU will have to comply with the due diligence requirements for securitisation investments and that such interpretation is not in its view extraterritorial given it is the activity, rather than the entity, that is considered relevant. As such, the EU Securitisation Regulation should apply to non-EU AIFM only in respect of funds marketed in the EU or managed in the EU. This is a welcome clarification from the Commission. The Commission is also going to consider amendments to remove any uncertainty in a future proposal to amend the EU Securitisation Regulation.

As regards sub-threshold AIFMs, the Commission determined that the EU Securitisation Regulation (and related regulation) does not distinguish between larger or smaller AIFMs and therefore sub-threshold AIFMs will be considered EU institutional investors for the purpose of the EU Securitisation Regulation.

## Due Diligence and Transparency

As discussed above, under Article 7 SSPEs, originators and sponsors are required to make available transaction documentation in respect of the securitisation and to provide ongoing data by means of standardised reporting templates. Under Article 5(1)(e) of the EU Securitisation Regulation EU institutional investors are also required to verify that the SSPE, originator or sponsor has made such information available.

The Commission acknowledged in the Report that certain respondents to the Consultation found these requirements to be disproportionate in scope, too prescriptive, strict and, in particular, that the requirements fail to take into account whether the particular securitisation is public or private. Respondents suggested that private transactions should have reduced requirements, as investors are actively involved in negotiating private transactions and thus are able to determine the scope of the information they require.

The Commission further acknowledged that it may be necessary to re-visit the scope of the information provided to investors, taking into account any information that investors do not deem relevant or necessary. The Commission requested in the Report that ESMA review the asset level

reporting templates to address any difficulties in completing fields, inviting ESMA to potentially adjust the templates to remove unnecessary fields and to more closely align the fields with investors' needs. Furthermore, the Commission has asked ESMA to consider whether the loan-by-loan information is useful and proportionate to investors' needs for all types of securitisations (potentially being not required for larger portfolios).

The Commission's decision to request a review by ESMA of the asset level reporting templates is a welcome one. Cadwalader has worked with the Loan Market Association ("**LMA**") and other industry groups in raising concerns over certain aspects of Article 7 and the corresponding reporting templates. We will continue to work with the LMA and other industry groups to raise these issues with ESMA as they begin the review requested by the Commission.

## Private Securitisations

The Commission considered whether the number of "private securitisations" (i.e. a securitisation where the notes are not listed on an EU regulated exchange (as distinct from a multilateral trading facility such as the Euronext Dublin Global Exchange Market) and therefore no prospectus is required to be drawn up in compliance with the Prospectus Regulation[7]) has increased as a result of the exemption of such transactions from reporting to the securitisation repositories. The Commission at this stage has determined that there is currently insufficient data and intends revisit the question in due course.

The Commission also acknowledged that a number of Consultation responses suggested that template reporting under Article 7 of the EU Securitisation Regulation should not be required for private securitisations given the specific nature of the reporting requirements and the ability of investors in such transactions to request information required on a transaction by transaction basis. However the Commission has maintained the view that template reporting provides information that is sufficiently high in quality while being easy to process.

Notwithstanding that view, the Commission has proposed that for private securitisations, regardless of asset class, there should be a single ESMA template that is tailored particularly to supervisors' need to gain an overview of the market and of the main features of private transactions. For private securitisations, that single ESMA template would take the place of the existing ESMA reporting templates. We hope that as a result, in the future, private transaction reporting under Article 7 will be simpler and more manageable which may help to mitigate the issues discussed above in respect of non-EU Securitisations.

The Commission also stated that the definition of "private securitisations" should not be amended due in no small part to the lack consensus among market participants as to what the definition should be. Instead, the Commission will look to create a separate template for private securitisation reporting as discussed above.

## STS Equivalence

The EU Securitisation Regulation sets out the criteria for "simple", "transparent" and "standardised" securitisations that must be fulfilled in order to satisfy an "STS" classification, resulting in potential lower risk weighting allocated to the particular securitisation investment. STS securitisations must be issued by an EU entity, however in the Consultation market participants requested that this be expanded to include non-EU issuers.

One suggestion made was the creation of an “equivalence” regime, which would allow non-EU Securitisations to qualify as STS to the extent the standards in the non-EU jurisdiction are sufficiently similar to the EU STS regime. The Commission however considered it “premature” to introduce equivalence. It acknowledged that the UK has a STS regime in place (inherited from the EU Securitisation Regulation as implemented in the UK) but references that the updated on-balance-sheet STS securitisation regime in the EU has not been included in the UK regime.

The Commission has said that it will continue to monitor regulatory developments in third country jurisdictions for potential future equivalence opportunities.

## Sustainable Securitisations

Many financial products in Europe are subject to extensive regulation regarding environmental, social and governance (“**ESG**”) factors, while in the securitisation market, currently only STS securitisations are required to make sustainability disclosures (which may include principal adverse sustainability impact disclosure). Although respondents to the Consultation were generally supportive of information disclosure requirements that would allow them to measure certain ESG factors, respondents also acknowledged that the parameters would potentially not be sufficiently clear in all asset classes for this to be effective.

The Commission considered the European Banking Authority (the “**EBA**”) report on developing a framework for sustainable securitisation published on 2 March 2022[8] and certain recommendations of that report were accepted by the Commission such that:

- given the small number of “green” assets, rather than establishing a dedicated framework for green securitisations, the EU Green Bond Standard (published in July 2021 and not yet final) should be adjusted to cater for securitisations; and

- principal adverse sustainability impact disclosures currently applicable to STS securitisations (being developed by the Joint Committee of the ESAs) should be developed to cater to all securitisations broadly.

The requirement for further ESG related information will be welcomed by investors (especially those with back-to-back disclosure obligations) however the requirements may cause issues where the underlying asset obligors are not themselves in a position to (or in some cases, required to) provide the information required to be disclosed. It is hoped that the concerns of participants in the Consultation are carefully considered by the EBA and the Commission.

## Securitisation Special Purpose Entities (SSPEs)

As required under article 46(h) of the EU Securitisation Regulation the Commission had considered whether a system of limited-licenced-banks could better perform the role currently undertaken by SSPEs in securitisation transactions, but determined that the current framework and use of SSPEs is operating in an adequate manner.

## Risk Retention

Under Article 6 of the EU Securitisation Regulation originators, sponsors, original lenders and (in the

case of securitisations of non-performing exposures) servicers are required to hold at least 5 per cent. of the net economic interest in the securitisation. EU institutional investors are also required to verify such risk retention pursuant to Article 5(1)(d) of the EU Securitisation Regulation.

While the Commission did acknowledge that there remains some legal uncertainty as a result of the delay in the adoption of the regulatory technical standards relating to risk retention, at this stage the Commission is not proposing any changes to the risk retention requirements under Article 6.[9]

The Commission did however leave open the possibility of a future examination as to why and in what circumstances one retention method is favoured over another and how effective each retention method is in retaining a proportion of the transaction.

## Third Party Verification of STS Criteria

Under the EU Securitisation Regulation certain third party verification service providers are able to assist market participants by assessing the STS status of a particular securitisation. Only two such service providers exist, with one in particular providing the majority of such verifications.

The Commission considered a potential lack of competition due to regulatory barriers, but determined that this was not the case and has therefore decided not to intervene.

## Prudential Treatment of Securitisations

The Commission is in the process of preparing a report which will partly consider the securitisation prudential framework as a whole. Of note here is that the Commission is assessing the appropriateness of the calibration of capital requirements for investments in securitisation tranches by insurance and reinsurance firms (currently in many cases a much higher capital requirement level than holding the underlying asset the subject of the securitisation), however there is no timing specified for the completion of such report.

## Significant Risk Transfer (“SRT”)

The Commission has acknowledged the EBA recommendations to simplify and harmonise the process by which SRT is achieved under the Capital Requirements Regulation and will be aiming to make this more efficient, transparent and consistent. No timescale is given for any potential report or amendments.

## Conclusion

Many of the determinations and outcomes of the Report are largely welcome, in particular the Commission’s invitation for ESMA to consider potential adjustments to the template reporting format under Article 7 with the purpose of focusing more on the information required for supervisory assessment rather than information not necessarily utilised by investors.

It should be noted however that the interpretation by the Commission of the applicability of Article 7 and Article 5(1)(e) of the EU Securitisation Regulation in respect of non-EU Securitisations may create additional hurdles in respect of the sale of non-EU Securitisations into the EU, at least until a more appropriate reporting regime is created for private securitisations.

**FOOTNOTES**

1 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2022%3A517%3AFIN&qid=1665402023328.

2 The ESAs are the European Securities and Markets Authority, the European Banking Authority and the European Insurance and Occupational Pensions Authority.

3 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Opinions/2021/964573/JC%202021%2016%20-%20ESAs%20Opinion%20on%20Jurisdictional%20Scope%20of%20Application%20of%20the%20Securitisation%20Regulation%20%28003%29.pdf

4 Regulation (EU) 2017/2402 which forms part of UK domestic law by virtue of the European Union (Withdrawal) Act 2018, as amended by the Securitisation (Amendment) (EU Exit) Regulations 2019 of the United Kingdom.

5 For more information on the contents of the opinion please see our Clients and Friends Memorandum dated 29 March 2021: https://www.cadwalader.com/resources/clients-friends-memos/european-regulators-publish-joint-opinion-on-the-jurisdictional-scope-of-the-eu-securitisation-regulation-.

6 https://www.cadwalader.com/resources/clients-friends-memos/eu-securitisation-regulation-disclosure-templates-published-in-the-eu-official-journal

7 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading

8 https://www.eba.europa.eu/sites/default/documents/files/document_library/Publications/Reports/2022/1027593/EBA%20report%20on%20sustainable%20securitisation.pdf.

9 For more information regarding the draft risk retention regulatory technical standards please see our Clients and Friends Memorandum dated 26 April 2022: https://www.cadwalader.com/resources/clients-friends-memos/the-eba-publish-final-draft-rts-relating-to-risk-retention-under-the-eu-securitisation-regulation.

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