ALERTS

The New UK Securitisation Regime: A First Step

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Final rules published by FCA and PRA on UK securitisation parties

On 30 April 2024, the FCA and PRA each published its final rules on the UK securitisation framework, using the powers delegated to each of them under the Securitisation Regulations 2024 SI (together, the "New UK Rules"). These rules contain the much awaited detail surrounding how the UK regulators will change key areas of the onshored version of the current UK securitisation regulation (the "Existing UK Rules") and derogate from its EU equivalent (the "EU Securitisation Regulation").

The New UK Rules will come into effect on 1 November 2024 (the "Implementation Date"). However, the existing regime will continue to apply for securitisations issued prior to the implementation of the new rules, except where a UK institutional investor delegates its due diligence requirements to a non-UK authorised AIFM (as discussed below).

Changes from the draft proposals

The New UK Rules are: (1) broadly in line with each other, to the extent they relate to the relevant firms under the FCA/PRA's legislative purview; and (2) not significantly changed from the Existing UK Rules nor from their respective draft rules published in the summer of 2023, given the stated intent by the FCA, PRA and His Majesty's Treasury was not to drive a change in the substance of current policy. The FCA and PRA have,

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however, made some changes in the following areas since their respective draft rules were published:

- Clarification that information must be provided either "before pricing" or at the time of an investor's "*commitment to invest in*" a securitisation under the due diligence and transparency requirements. In particular that for primary market investments, documentation provided on pricing can be in draft or initial form, with final versions to be made available within 15 days after closing of the transaction; whereas for secondary market purchases the documentation should be provided in final form before the commitment to invest;

- Distinction between secondary and primary market investments so secondary market investors are not required to conduct diligence on information which is no longer relevant;

- Clarification that a UK institutional investor may delegate its due diligence to another investor, which may or may not be an 'institutional investor' as defined for the purposes of the New UK Rules, provided that the UK institutional investor retains the responsibility for compliance with the due diligence requirements where the delegate is not a UK institutional investor;

- Clarification that appointment of a UK third party verifier to assess compliance with the UK STS criteria will not affect the liability of the originator, sponsor or SSPE in respect of their obligations;

- Alignment of the PRA rules with the equivalent FCA rules on transparency requirements allowing PRA firms to disclose data in an aggregated or anonymised form (or in relation to underlying documentation, as a summary) in circumstances where UK law relating to confidentiality and/or processing of personal data relating to customer, original lender or debtor information do not allow more 'granular' disclosures; and

- Introduction of transitional provisions for pre-Implementation Date securitisations, see further below.

Other points to highlight

As a result of the New UK Rules coming into effect on the Implementation Date we have summarised certain key considerations for clients below

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(having also taken into account the unchanged draft proposals by the FCA and PRA in 2023 which are now reflected in the New UK Rules):

- The so called originator "sole purpose" or "entity of substance" test under the New UK Rules differs from its EU Securitisation Regulation counterpart (which otherwise has been largely mirrored) where the FCA and PRA have adopted the draft language proposed by the EBA in 2018 rather than the EU Final Risk Retention RTS. Under the New UK Rules:
  - The stated factors are to be "*taken into account*" rather than act as requirements to fulfil the safe harbour which they do under the EU Final Risk Retention RTS, for an originator to satisfy the test; and
  - When considering whether the risk retainer relies on the exposures to be securitised, on any retained interest, or corresponding income from such exposures and interest there is no reference to such being its "*sole or predominant source of revenue*".
- The requirement under the Existing UK Rules for UK institutional investors to receive "substantially the same" information as that contained in the FCA reporting templates where a UK investor is participating in a non-UK securitisation has been removed. The requirement to receive certain key information (in a non-prescibed form) such as the transaction documents and quarterly investor reports including the key economics of the deal and the exposures, will apply to UK investors in all securitisations;
- The use of a non-refundable purchase price discount for calculating the retention of non-performing securitisations was included in the New UK Rules, allowing the 5 per cent retention requirement to be measured at market value of the portfolio at the time of the securitisation rather than the full notional value of the financing (or the "par" value);
- Whereas the EU rules lift the prohibition on selling the retained interest where the retainer, for legal reasons beyond its control and beyond the control of its shareholders, is unable to continue acting as a retainer, the UK rules on the other hand only provide relief upon the insolvency of the retainer or where retention is on a permitted consolidated basis;
- The ability for the risk retainer to use its retained interest as collateral for secured funding purposes including those which involve a sale, transfer or other surrender of all or part of the rights, benefits or obligations thereof, has been preserved provided that such use as

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collateral does not result in a transfer of credit risk from the retainer to a third party of the retained interest;

- The retainer may hedge the net economic interest where the hedge is undertaken prior to the securitisation as a prudent element of credit granting or risk management and does not create a differentiation for the retainer's benefit between the credit risk of the retained securitisation positions or exposures and the securitisation positions or exposures transferred to investors;
- There is no need for risk retention in relation to securitisations of an entity's own liabilities (e.g. own issued covered bonds);
- Originators may select assets to be transferred to the SSPE with ex ante a higher than average risk profile than assets remaining on the balance sheet provided that this is clearly communicated to investors or potential investors;
- Retranching by the securitisation's originator of an issued tranche into contiguous tranches shall not constitute a securitisation; and
- the relevant reporting templates have also been published by the FCA and PRA.

Future developments

The FCA and the PRA have indicated that they both intend to consult further on potential changes to the securitisation framework in Q4 2024 and early 2025, although timings are subject to change. Areas we would expect to see up for discussion in the next round include the definition of public and private securitisations and the related reporting regime along with a general aim of making the reporting regime more proportionate.

It should always be borne in mind that the whole point of devolving the onshored legislation into the FCA and PRA rulebooks was to enable a more rapid response by regulators, without involving legislative change, to changing markets and specific events as well as changes implemented in the closely tied EU regulations. Whether this eventually leads to a wider shift from the EU Securitisation Regulation remains to be seen, but it has certainly been hinted at.

Looking further into the (perhaps distant) future, it is possible to imagine much more significant deviations from the EU rules and the existing UK

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rules being implemented, whether that could be changes to the actual definition of "securitisation", the introduction of ESG elements or a widening of the STS criteria to permit managed CLO transactions to qualify, perhaps...

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