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ESMA Publishes Details of New Disclosure Regime for Structured Finance Instruments

On 24 June 2014, the European Securities and Markets Authority ("**ESMA**") published its long-awaited final draft of the regulatory technical standards implementing the disclosure requirements imposed under Article 8b of the Credit Rating Agencies Regulation (the "**RTS**"). These disclosure requirements apply to so-called "structured finance instruments" (or "**SFI**"), which are defined to include any financial assets resulting from a securitisation, regardless of whether they are unrated, private, bilateral, intragroup or indeed not even a "security" for regulatory purposes. In this briefing, we highlight the main changes to the RTS since the draft originally published for consultation and a few areas of concern that remain.

The final draft RTS published earlier this week has a number of important differences compared to the draft RTS published for consultation in February of this year. A number of the changes address concerns that industry raised with the initial draft and it is apparent that the consultation process has been useful for both industry and ESMA. The differences include:

- **Extended grandfathering period:** Although the RTS will technically come into force 20 days after its publication (unlikely to be before September or October 2014), it will not apply until 1 January 2017. What's more, the transitional provisions make clear that (i) the disclosure obligations only apply to SFI issued after the RTS comes into force and which are still outstanding on 1 January 2017 or to those issued after 1 January 2017; and (ii) no "backlog" of information need be kept between the entry into force and the application of the RTS.
- **Phase-in for certain transactions:** The RTS still covers private, bilateral transactions, but now only on a "phase-in" basis. If a private deal doesn't fit clearly within one of the asset classes set out in Article 6 of the RTS (being residential mortgages, commercial mortgages, SME loans, auto loans, consumer loans, credit card loans and leases to individuals and or businesses), no disclosure obligations – loan-level or otherwise – apply until a new template is published appropriate for the transaction. This seems likely to exclude a large number of private securitisations outside of the traditional asset classes mentioned above from reporting for the time being. It seems that ABCP, synthetic securitisations and re-securitisations (along with any other asset classes that don't fit precisely into the categories mentioned above) have been put into the same "phase-in approach" bucket where the disclosure obligations won't apply initially.
- **Cash flow model removed:** The obligation to publish a separate cash flow model has been removed, but the transaction documents required to be published must include a detailed description of the waterfall of

payments, which market practice would normally require anyway.

- **Transaction summary removed:** No transaction summary need be published if a PD prospectus has been published in respect of the SFI.
- **Reporting frequency linked to IPDs:** Reporting of loan-level information and investor reports are required to be published quarterly with dates linked to the interest payment dates of the notes issued under the securitisation.
- **Event-based reporting limited:** Event-based reporting for SFI subject to the EU market abuse regime has been restricted to reproducing any reports prepared under that regime on the ESMA website. There had previously been concerns that the two regimes would conflict, causing confusion for issuers. It seems that concern will likely now fall away. However, where the SFI is not subject to the EU market abuse regime, there remain event-based reporting requirements where there is a "significant change or event" involving (i) a breach of the documentation, (ii) structural features that can materially impact on the performance of the SFI; or (iii) the risk characteristics of the SFI and of the underlying assets.
- **Designation of reporting entity made optional:** The designation of a reporting entity by the issuer, originator or sponsor is now optional, and the designation of multiple parties has been made possible (but any designation of a reporting entity is without prejudice to the responsibility/liability of all those parties to report).

There are also a number of areas where industry had been hoping for changes, but where the final draft RTS remains materially unchanged from the initial draft published for consultation. These include:

- **Extra-territoriality:** Concerns remain as to the extra-territorial effect of the disclosure regime, as the reporting obligations apply as soon as any of the issuer, originator or sponsor is established (and for that purpose has its statutory seat) in the EU. The result is that what appears to be an entirely foreign securitisation could be caught by the disclosure rules if e.g. a foreign branch of an EU established bank sponsored the deal, and each of the issuer, originator and sponsor would be made liable for any failure to comply.
- **Remaining broad scope:** All SFI, regardless of whether they are rated, private, intra-group, or fall within the definition of a "security" etc. would still technically be subject to disclosure obligations under the final draft RTS and would therefore eventually be subject to reporting obligations. While the phase-in approach is very helpful, possibly even for several years, it now seems clear that the text of the CRA Regulation itself will need to be changed if private, bilateral, unrated and other transactions industry considers ill-suited to these types of disclosure obligations are to be permanently exempted from reporting.
- **Credit card loan level reporting:** Credit card ABS are still subject to loan-level reporting requirements in line with the ECB templates, despite the fact that these templates are largely untested and major credit card users have significant and legitimate concerns (and hence are not using them). ESMA has, however, "noted the concerns of the market participants and will closely monitor and follow-up on new developments in this respect with any related parties". As other regulators, such as the SEC and the Bank of England do not require loan-by-loan data on credit card assets and, as we understand, it is not useful to or required by investors, it is hoped that this process will result in credit card loan-level reporting ultimately not being required for credit card ABS.

Conclusion

The development of the RTS thus far has benefitted from extensive engagement between industry and regulators. It is hoped that this engagement will continue through the rest of the development of the RTS, resulting in rules that promote the transparent, efficient and well-functioning markets that are the common goal of regulators and market participants alike.

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