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CRA3: Commission Adopts Detailed Disclosure Rules for Structured Finance Instruments

On 30 September 2014, the EU Commission (the "Commission") adopted a set of regulatory technical standards ("RTS") setting out how market participants will need to comply with Article 8b of the EU's Credit Rating Agencies Regulation. The version adopted by the Commission is broadly in line with expectations and similar to the final draft of the RTS adopted by the European Securities and Markets Authority ("ESMA") on 24 June 2014. In this alert, we explain some of the outstanding issues and the most important differences between ESMA's final draft RTS and the version adopted by the Commission.

As with previous drafts, the RTS adopted by the Commission yesterday require disclosure in relation, broadly, to all "structured finance instruments" or "SFI" (i.e. financial instruments or other assets resulting from a "securitisation" within the meaning of the CRR) where at least one of the issuer, originator or sponsor is established in the EU. They require public disclosure on a website to be established by ESMA of transaction documents, investor reports, loan-level data at least quarterly, and certain event-based disclosure as well. We have previously published client briefings on the latest amendments to the Credit Rating Agencies Regulation (collectively referred to as "CRA3") and on drafts of the RTS to be made under Article 8b. These are listed on the final page of this briefing.

In relation to the RTS adopted by the Commission yesterday:

- The existing broad scope of the reporting obligations relating to all structured finance instruments remains. This is without regard to whether the SFI is a security, whether it is offered to the public, or whether it is rated.
- The extra-territoriality problems we have previously highlighted in relation to ESMA's final draft RTS remain. That is to say, if any of the issuer, originator or sponsor is established in the EU then the transparency obligations apply to all three of them. This makes the reach of these transparency obligations very broad, and is potentially a disincentive for third country entities to enter into securitisation transactions with EU entities. It is also potentially an incentive for EU entities to act through locally-incorporated subsidiaries in third countries (which will generally be considered to therefore be locally "established"), rather than through branches.

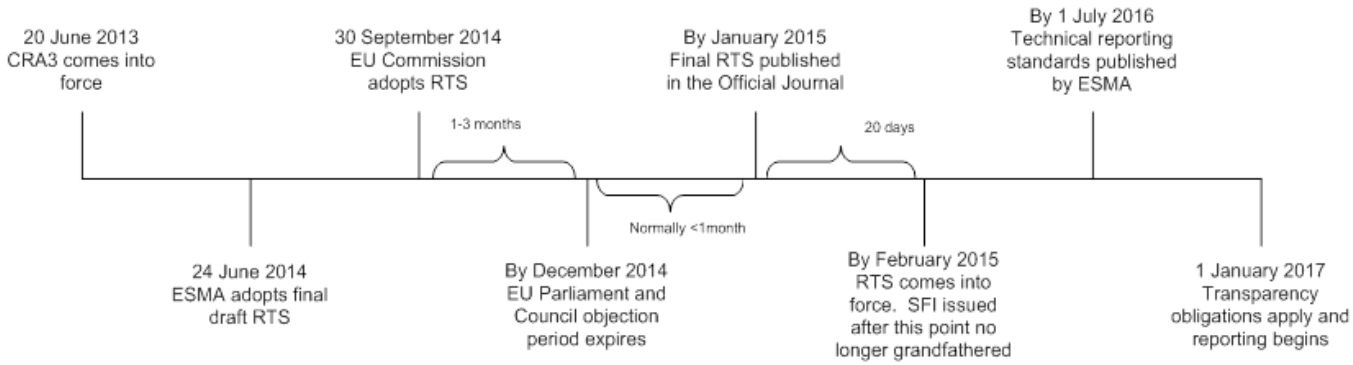
Key issues

- Wide ranging transparency obligations for structured finance are now just a few months away from being finalised
- Structured finance instruments issued after the new obligations come into force will not be grandfathered
- Reporting of regulated information will start on 1 January 2017
- Data to be reported is very similar to that already reported to European DataWarehouse for ECB eligible assets.

- The data templates for loan-by-loan reporting under the RTS require much the same information as the existing ECB reporting templates, save that the RTS reporting omits some fields. While this is to some extent helpful, it still means that there could potentially be three sets of data provided for some transactions, i.e. the local central bank, the European Data Warehouse (for the ECB) and ESMA.
- ESMA introduced the idea of a phase-in approach in its final draft RTS, whereby reporting obligations would initially only apply to certain classes of SFI (specifically, those backed by residential mortgages, commercial mortgages, loans to SMEs, auto loans, consumer loans, credit card loans, or leases to individuals and/or businesses). The obligations would then later be rolled out to other classes once technical reporting templates could be developed for them. This approach is retained, but the concept of a "private or bilateral" transaction as one that is excluded for the moment has been clarified. In this respect, the Commission version of the RTS states at Recital (4):

  "…[the] standardised disclosure templates and all reporting obligations under this Regulation should apply only to structured finance instruments that are backed by underlying assets [on the above list] and which in addition are not of a private or bilateral nature." (emphasis added)

  No definition of "private or bilateral in nature" is included in the RTS. There are, however, a range of indicia one could look at, such as breadth of distribution, transfer restrictions and listing status, that would point one way or the other. The Commission's explanatory memorandum accompanying the RTS also specifically lists ABCP, synthetics, re-securitisations, and securitisations with heterogenous asset pools as other categories of SFI that are subject to this phase-in approach.
- Small changes have been made to clarify the scope of the obligation to disclose transaction documents. These are helpful in that they change the standard for disclosure of a document from anything which is a "relevant" underlying document to the (clearer and easier to comply with) standard of anything which is "essential for the understanding of the transaction".



- The Commission version of the RTS sets a deadline of 1 July 2016 for ESMA to publish the "technical reporting instructions" for how to report the information required by the RTS. Previously this had been contemplated generally as something ESMA would need to produce, but no deadline had been set".
- Finally, the Commission version of the RTS also retains the existing problems relating to allocation of responsibility for reporting. The RTS allows for data to be reported by one or more "reporting entities" appointed jointly by the issuer, originator and sponsor. This does not, however, relieve the issuer, originator and sponsor of their joint responsibility for the timeliness and accuracy of reporting. There is also still no mechanism for resolving disputes should any arise among the parties responsible for reporting.

Next Steps and Grandfathering

The adoption of the RTS by the Commission means that they are now getting close to being formally approved and coming into force. The European Parliament and the Council now have a one month objection period which they can extend twice, by one month each time, for a maximum of three months in total. Provided that neither the Parliament nor the Council objects within that timeframe, then the RTS can be published in the Official Journal and will come into force 20 days later. The transparency obligations under the RTS, however, do not apply until 1 January 2017.

Any SFI issued prior to the coming into force of the RTS will be grandfathered. However, the issuer, originator and sponsor of any SFI issued after the RTS come into force and still outstanding on 1 January 2017 will be subject to the transparency obligations. No backlog of information need be kept, however, between the coming into force of the RTS and 1 January 2017.

It is unclear how grandfathering will work in relation to SFI that are subject to the phase-in approach. For example, it would be quite difficult to include appropriate covenants and plan properly for the disclosure obligations relating to ABCP or a synthetic securitisation in the absence of a disclosure template specifying what information will need to be disclosed. Nonetheless, no grandfathering provisions exist that specifically contemplate SFI subject to the phase-in approach.

Conclusions

This can be viewed as the latest step in a conversation about increased transparency between industry and regulators that has been going on since the onset of the financial crisis. Although these RTS are now close to final, that conversation will doubtless carry on, particularly around the disclosure templates; indeed, the phase-in approach being adopted for many assets virtually guarantees this. It is hoped that this continued engagement will produce data templates that provide investors with the data they require without undue burden on originators and sponsors, particularly for asset classes such as credit cards where the data templates to be used are as yet largely untested and their value doubted.

Another ongoing issue is that the definition of securitisation that underlies the concept of an SFI is too broad and imprecise. There is already a level of discussion around amending the definition of securitisation among market actors and we hope constructive engagement with regulators will have positive effects in a number of areas where regulation is currently having unintended consequences on transactions that would not be regarded as securitisations by the financial markets. Moreover, in the context of the RTS, the definition of SFI exacerbates the confusion surrounding "private and bilateral" transactions, among other things. It seems obvious to market participants, for example, that private transactions should be excluded in a more permanent fashion from a regulation that is aimed at the public markets (including ratings) for securitisation instruments.

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