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EU SECURITISATION REVIEW: TWO MONTHS ON

On 10 October this year, the European Commission published its widely anticipated review report (the "**Report**") on the functioning of the EU Securitisation Regulation (the "**EUSR**"). The aspects of the Report dealing with the EUSR disclosure regime (and corresponding diligence obligations) were arguably the most significant. Indeed, the *de facto* exclusion on EU institutional investors investing in certain non-EU securitisations prompted an industry letter requesting relief. In this briefing, we discuss the consequences of the Report two months on and the next steps from here.

Key issues

- The Commission's interpretation preventing EU institutional investors from investing in non-EU securitisations due to non-compliance with EU transparency requirements remains an issue
- Industry have submitted a letter to the ESAs asking for relief to help manage the issue until new templates are published
- The ESMA process for creating new templates is taking a "back-to-basics" approach, which means the outcomes at this stage remain very unpredictable
- Securitisation looks likely to be meaningfully incorporated into the forthcoming European Green Bond Standard
- The ESAs' advice on securitisation prudential issues has been published and is generally viewed by the market as disappointing – an issue we intend to publish a briefing on separately in early 2023

BACKGROUND AND FOCUS OF THE REVIEW REPORT

For a general summary of the contents of the Report, see our initial briefing on it, available here.

The Report sets out a number of proposals, guidance and clarifications which are already starting to have an impact on issuers, investors, sponsors and other transaction participants in the European securitisation market.

ARTICLE 5(1)(e) PROBLEM AND PRIVATE TEMPLATES

Two months out from the publication of the Report and the spotlight remains on the Commission's statements in relation to the interpretation of Article 5(1)(e) of the EUSR. So much so that on 9 December 2022, thirteen major trade associations signed a joint letter on which Clifford Chance held the pen requesting relief from this particularly troublesome aspect of the Report (the "**Request for Relief**").

Article 5(1)(e) sets out the requirement for institutional investors to verify that the sell side entities in securitisations (the originator, the sponsor or the SSPE) have, "where applicable", made available the information mandated under Article 7 of the EUSR. The greatest focus in this respect tends to be on templated periodic reporting, but it also covers transaction documents essential for investors to understand the deal. EU institutional investors are also required specifically to check that the information is disclosed "in accordance with the frequency and modalities provided" for in that Article 7.

In respect of securitisations where there is at least one EU sell-side entity, this tends to be relatively straightforward, if a bit burdensome. There is a direct obligation for EU originators, sponsors and SSPEs to comply with the

reporting requirements under Article 7, so institutional investors are really just checking the sell side's homework.

Third country securitisations

The picture is a bit more difficult where none of the sell-side entities on a deal have direct obligations to comply with the EUSR. The question for EU regulated investors has been, since the EUSR first came into force, whether the EUSR was effectively prohibiting EU regulated investors from putting their cash into deals with issuers and sponsors outside of the EU unless reporting on those transactions was produced in line with the EUSR reporting requirements, not just in substance but also in (highly prescriptive) form. A wide range of views developed, but eventually a significant number of market participants came to the conclusion that – provided they received adequate information to do responsible credit due diligence – there was no strict requirement for EU institutional investors to receive reporting in the precise EU format. EU institutional investors were therefore commonly investing in third-country securitisations without fully EU-aligned reporting.

The Report has resolved this question by confirming that EU institutional investors in third-country securitisations[1] are required to check for full Article 7 information, in both form and substance. They do not have discretion to decide that disclosure in another format is "materially comparable information" and invest anyway.

The Commission did acknowledge that there has been some confusion on this point in the market and that the issue may merit reconsideration in the context of future amendments to the level 1 text, but the issue here is a timing one. There is no grandfathering in respect of this interpretation of the Article 5(1)(e) requirements – indeed it is in some sense retroactive since formally what the Report does is interpret an obligation that has been on EU institutional investors since 1 January 2019. While we think the issue with existing non-compliant positions held is manageable (as to which see below), read strictly the Report does impose an immediate stop on further investments in securitisations that do not provide full Article 7 disclosure, and amendments to either Article 7 or the detailed disclosure rules made under it will not be immediate.

New templates: a way forward?

As the Report points out, its separate recommendation to move towards simpler and less prescriptive reporting templates for private securitisations should help to solve the problem in the medium term. There is certainly widespread market support for a new, simpler private securitisation reporting template. The Commission's hope – shared by many market participants – is that this new template will serve the purpose of providing regulators with information they need to understand and regulate the market while recognising that, in private transactions, investors can negotiate appropriate disclosure for themselves reflecting what they really need to conduct appropriate, responsible due diligence. These recommendations are discussed further below but it is clear that they won't be a panacea. ESMA has started to engage on the question of private templates and there is a consultation process due to take place in 2023 but we will not have new reporting templates next week; indeed, given the legislative process necessary to implement the new templates, there is a reasonable chance we

[1] Securitisations where none of the sell-side entities is located in the EU.

won't even have them next year. New templates may still go beyond what issuers and sponsors of third-country securitisations can or would be willing to provide and – despite the Commission's clear direction of travel in the Report – it is not certain that ESMA will produce a single new template across all asset classes or that there will be uniform requirements for all types of underlying exposures. Indeed, given the clear "back-to-basics" approach ESMA is taking in its initial, informal industry consultations on this work, it is hard to say very much at all about what the templates will look like after the current review exercise has finished.

The problem of existing positions

In the meantime, investors holding potentially non-compliant positions will need to consider what consequences or enforcement action there might be under their relevant regulatory prudential framework[2] and what next steps should be. On the investment side, the details will vary according to the type of institutional investor, but there is no cause to begin conducting an immediate fire sale of non-compliant positions. It is highly unlikely that would be appropriate or in the best interests of investors, and most prudential regulatory frameworks place an overriding obligation on institutional investors to take action in the best interests of their investors. Rather, EU institutional investors with existing non-compliant positions should seek advice on their particular situation, with the most likely outcome being that they will need to identify their non-compliant positions and make a detailed plan in order to determine in each case whether it is best to try to make the position compliant, dispose of it, or document why the position is being kept despite its lack of compliance.

On the question of consequences on institutional investors for entering into these non-compliant positions, it will again be a question for the relevant prudential regulatory framework. That said, it would be surprising if regulatory authorities were to take a harsh view of historic non-compliance in this case given that most EU institutional investors will have followed their then-current procedures which were, in turn, based on their reasonable interpretation of the law at the time. It also helps that the Commission has acknowledged that there has historically been significant confusion about what Article 5(1)(e) required in respect of third country securitisations.

So what do we do while we wait for new templates?

This problem is more difficult. EU institutional investors have been on notice since 10 October 2022 that Article 5(1)(e) requires them to get full EU-style disclosure even in respect of third country securitisations. That said, the Request for Relief points out a number of real problems with this, and offers several illustrative examples of the damage this approach would cause. It is, therefore, the product of a significant number of industry bodies seeking to combine forces and obtain some clarity on the immediate way forward.

As pointed out in the Request for Relief, it seems vanishingly unlikely that great numbers of third country sell-side entities would be prepared to start producing Article 7 disclosure now, in the context of those disclosure rules being actively under review. Many will at least want to wait and see what the new private securitisation templates look like before committing significant time and resources to systems updates and training. The Commission itself recognises that the level 1 text "de facto excludes EU institutional investors

[2] There are no sanctions provided for under the EUSR itself.

from investing in certain third-country securitisations". That EU institutional investors would be excluded from a significant portion of this market is an issue not just in the interim period before new private securitisation templates are introduced. Being cut-off from opportunities in this way could lead to less diversification of risk, the erosion of borrower/investor relationships which have been established over many years and the loss of skills and resources where business lines are narrowed. At a wider level, investors in pension funds, for example, may lose out on opportunities for yield and exposure to certain asset classes and jurisdictions and there may be knock-on effects for liquidity in securitisation markets which could in turn increase the cost of certain types of funding to the real economy.

In the absence of powers to grant US-style "no action" relief, the Request for Relief proposes that guidance should be issued by the European Supervisory Authorities[3] to national regulators that they should take a proportionate and risk-based approach in their day-to-day-supervision and enforcement of Article 5(1)(e). This would have the advantage of giving some comfort to investors that they could continue to make investments in third country securitisations between now and the time any new disclosure templates are published. It also reflects the fact that the credit work being done on these transactions often reflects, in substance if not in form, the diligence an investor would be required to undertake under the EUSR. Until the Request for Relief gets a response, EU investors will need to think carefully about what their risk appetite is when considering investments in third country securitisations.

PUBLIC VS PRIVATE: A MORE NUANCED APPROACH ON TRANSPARENCY

In addition to the Article 5(1)(e) question, the Report looks at reporting more widely and recognises that current requirements in relation to transparency are not well matched to the needs of investors.

The Report notes that there are some issues with specific fields in the ESMA reporting templates, for example, where the required information isn't clear or is required to be provided more than once. It also queries the necessity of requirements for loan-by-loan data for all assets classes, notably the most granular and dynamic pools.

The Commission has therefor invited ESMA to review the forms of disclosure templates in order to make certain fields more user-friendly and aligned to investor needs. As mentioned above, ESMA is currently considering this mandate along with the mandate to produce a separate template for disclosure in respect of private securitisation. ESMA has not given any indication of where it might come out, but it is clear from its initial consultation that (within the limits of the level 1 text), it is very much going back to basics and taking a wide view of its mandate, making it extremely difficult to predict what form any disclosure templates made under the EUSR will take following the current review exercise, or whether any market expectations formed based on the Report will be met.

To the extent that private securitisation templates are produced and these are much simpler than those for public deals, the Commission has expressed some concern that this should not drive more transactions into the private

[3] The collective term for the European Securities and Markets Authority (ESMA), the European Banking Authority (EBA) and the European Insurance and Occupational Pensions Authority (EIOPA).

markets. It was clear from the Report that the Commission is alive to the potential for the distinction to be exploited in the future. This may become an area of increased focus for regulators in light of this proposed bifurcation of reporting requirements between private and public deals. It is not clear how the Commission would propose to monitor what it considers to be the appropriate categorisation of private securitisations although it may initially look at transaction volumes as compared to previous periods as a yard stick.

GREEN SECURITISATION AND PRUDENTIAL ISSUES

In addition to disclosure and due diligence, there has been progress in two other areas mentioned in the report.

On sustainable securitisation, the Report endorsed the EBA's suggestion to incorporate securitisation into the forthcoming European Green Bond Standard (the "**EuGBS**"). The regulation implementing the EuGBS is currently in the final stages of the EU legislative process, with the final political agreement expected in January. We understand, however, that the intention remains to incorporate significant securitisation-specific drafting so as to make the EuGBS useable by securitisations. This is despite the fact that none of the Commission, Council or Parliament's versions of the legislation included significant provisions of this type (although the Parliament's version did include the general principle).

On prudential matters, the Report deferred any substantive conclusions until The Commission received advice from the European Supervisory Authorities. That advice was published on 12 December and is generally viewed by the market as disappointing. Clifford Chance intends to publish a briefing on this subject early in 2023.

CONCLUSION

Overall, the effect of the Report and the ESAs advice on prudential matters paint a picture of an official sector (and a political environment more broadly) that supports securitisation in principle but who may not yet be prepared to take the steps needed to revive the product in such a way as to allow it to contribute to the real economy on the scale of its potential.

For now, the markets are in something of a wait-and-see mode. While market participants are actively engaging with ESMA on its review of the templates, the outcomes of that process remain uncertain. Likewise, the Commission's reaction to the ESAs' advice on prudential matters and the ESAs' response to the Request for Relief. There is reason to hope for further positive developments in 2023, but much work still to be done before they materialise!

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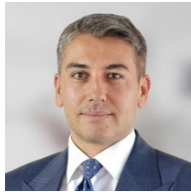

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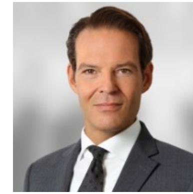

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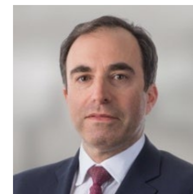

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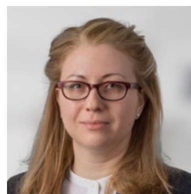

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