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C H A N C E

UK FCA PUBLISHES SECURITISATION CONSULTATION

On 7 August 2023 the Financial Conduct Authority published its consultation on new securitisation rules. The FCA's consultation needs to be read together with the equivalent Prudential Regulation Authority consultation and the UK Government's near-final statutory instrument and policy note. When finalised, these will together replace the UK Securitisation Regulation, which is currently retained EU law. In this briefing, we consider the main elements of the consultation and next steps in the UK Government's "Smarter Regulatory Framework" project as it applies to securitisation.

Key issues

- The FCA have published a consultation on their new securitisation rules to replace the UK Securitisation Regulation.
- The FCA consultation should be read with the equivalent PRA consultation and the UK Government's near-final SI and accompanying policy note.
- The FCA draft rules largely mirror the equivalent PRA rules but cover a number of additional areas, including STS securitisation, third-party verifiers and securitisation repositories.
- In addition to the draft rules on which it is consulting, the FCA has also published a set of policy ideas for discussion to do with disclosure rules. These are expected to be the subject of a further consultation next year.
- A number of structural, interpretation and other background matters need to be taken into account as well as the text of the rules themselves. These could be significant sources of uncertainty and unintended consequences.

The FCA consultation is the last of three consultations to be published on replacing the UK Securitisation Regulation with domestic law. We have previously published briefings covering the UK Government's "near-final SI" and the PRA's securitisation consultation. The FCA's document is also by far the longest of the consultations, running to over 700 pages. This is explained by the broader nature of the FCA's consultation as compared to the PRA document, with large portions of the Securitisation Sourcebook ("**SECN**") devoted to matters for which the PRA does not have corresponding responsibility, such as STS securitisation, and the regulation of third party verifiers and securitisation repositories.

Overview of the FCA's proposals

The FCA proposals largely mirror the PRA proposals we described in our briefing last week as far as shared areas are concerned. The same adjustments to due diligence requirements and delegation, risk retention on NPE securitisations, disclosure timelines, risk retention technical standards etc. are mirrored (albeit in different form) in the proposed FCA rules. We do not propose to repeat that summary here. Rather, we thought it would be useful to point out areas where our review of the FCA consultation has thrown up new issues or there are notable differences as compared to the proposed PRA rules:

- **Drafting:** A slightly technical one to start with, but the FCA takes a very different approach to its rules as compared to the PRA. The PRA have taken a relatively straightforward "lift and shift" approach, largely preserving words, formatting and even rule numbering from the UK Securitisation Regulation and the relevant technical standards. The FCA, on the other hand, have fully reformatted and redrafted the rules, aiming to make them clearer in what their consultation paper refers to as "Handbook-style drafting" or "HSD". Helpfully, they have included a "derivation and changes" table in their consultation document to assist with matching up existing rules with proposed new ones.

- **Confidentiality:** We noted last week that the PRA's draft rules made no provision for manufacturers of securitisations to anonymise or aggregate their reporting to avoid disclosing confidential information. It is with some relief that we note the FCA rules do preserve these confidential information provisions. What is more, the FCA rules make explicit (see proposed SECN 6.2.7R) that disclosure may be anonymised or aggregated in order to comply with confidentiality restrictions. It is not clear to us how this difference between the rules fits with the requirement on the regulators to "have regards" to the overall coherence of the regulatory framework the Government intends to impose in the SI. Market participants might consider feeding back to the PRA consultation encouraging them to adjust their rules to match the FCA's approach.
- **Resecuritisation:** We also noted last week that the ban on resecuritisation was subject to a new architecture that provides for a ban and the ability to grant permissions despite that ban. But it no longer has a description of the specific circumstances in which resecuritisations may be permitted. In the PRA's case this was paired with a draft statement of policy about the PRA's intended use of the new s.138BA of FSMA to grant permissions, the substance of which broadly preserved the status quo. The FCA takes a similar approach in its rules, and says its "current policy intention is that [they] would usually envisage using [their] powers to allow a resecuritisation only in circumstances broadly similar to those in which we could currently grant permission for a Resecuritisation under Article 8(2)" of the UK Securitisation Regulation. That said, it has no draft statement of policy equivalent to the PRA's. Instead it refers to making use of "existing (e.g., s. 138A of FSMA) and/or future powers" to grant the relevant permissions. Presumably the "future powers" the FCA might rely would be s. 138BA or s. 71N(4), but the difference in approach is not explained by either regulator. Given there are slightly different conditions attached to each power to give permissions it will be interesting to see how this plays out in practice, especially since in practice it looks like permission from both regulators will be needed to make a permission workable.
- **"No action" style relief:** Much was made at the time of the original draft securitisation SI being published of the possibility that "no action" letter-style relief might be available under the new regime where particular situations were identified that needed exemption from the rules, as it is under the US regulatory regime. That power comes from s. 71N(4) of FSMA and continues to be provided for in the near-final SI, but the FCA's consultation does not shed much further light on this, saying only that they "plan to provide more detail on this aspect of [their] rules in due course". Given that one of the requirements for exercising this power is that it must be provided for in the rules themselves, it is unclear whether the FCA intends to make use of this power for now.
- **Preservation of templates:** For both STS notifications and general disclosure templates, market participants have made large investments of time and money in systems designed to comply with these requirements. The FCA have made clear that, while they do expect to make changes to

these templates in due course, they are not doing so now and they expect "that there will be no changes resulting from this first consultation to the way firms populate or submit templates".

- **STS and homogeneity:** The FCA is proposing to make some relatively minor changes to STS and homogeneity. One such change is making clear that having a securitisation special purpose entity (SSPE) is not required to have an STS deal (although the requirement for a "true sale" remains). This has been a bit of a vexed question to date, so that clarification is welcome. A second is that notifying STS is optional. The current text suggests that, where a deal is eligible, notification is mandatory – although it is not in fact interpreted or applied that way as far as we are aware. Finally, SECN would bring into UK law a number of the changes to the homogeneity rules recommended by the EBA for the EU earlier this year.
- **Private rights of action:** The FCA consultation makes clear that the intention is for there to be no private rights of action under the FCA rules. That is, one private party cannot sue another with its failure to comply with the regulatory obligations imposed by SECN as the cause of action. This is by contrast to the position under EU law where the doctrine of "horizontal direct effect" would permit exactly that.
- **Transitional provisions:** The FCA proposes to rely entirely on transitional provisions to be included in the eventual securitisation SI. We have not yet had a chance to check whether these will be adequate, but this is an area market participants may wish to consider carefully to ensure there are no gaps or surprises resulting from the move from retained EU law to the new regime.

Disclosure changes coming down the track

In addition to the changes it is currently consulting on, the FCA is also floating a number of ideas for discussion about how the disclosure rules might be adjusted in future. In particular, they have published for feedback some ideas about how to adjust the "public vs private" distinction. To date, a "public" securitisation has been one for which a UK prospectus is required (broadly, bonds listed on the regulated market of the London Stock Exchange). This has the benefit of creating a clear bright line, but also has the effect of excluding a number of securitisations that could reasonably be described as public. The FCA is therefore considering a broader definition of public, that would include any securitisation with at least one UK manufacturer (originator, sponsor, or SSPE) that meets any of the following tests:

- primary listing on a UK regulated market or "appropriate equivalent non-UK venues";
- primary admission to trading on an "appropriate UK MTF and similar non-UK venues"; or
- a public announcement or other general communication is made to a wide audience of potential investors, intended to solicit orders or expressions of interests as part of the primary marketing of the securitisation.

Notably, this adjustment to the definition of public securitisations would presumably bring into the definition of "public" all those UK securitisations currently listed on EU regulated markets and MTFs, such as the Irish Stock Exchange's GEM, which is a popular listing destination for, e.g., CLOs and CMBS deals. This is likely to be viewed unfavourably by some sections of the securitisation market. In particular, it may be problematic for synthetic securitisations, which are often listed on non-regulated markets for tax reasons, or initially marketed to a large number of investors, even though the final transaction is still negotiated and executed on a private basis.

This proposed change is paired with a suggestion that disclosure templates for private securitisations could be made more proportionate or principles-based. The FCA also suggest that more limited adjustments to disclosure templates for public securitisations might be appropriate, especially in respect of the level of detail required on the underlying exposure/borrower for very granular and short-term pools such as credit cards.

The broader context

Now that all three elements of the replacement for the UK Securitisation Regulation have been published, a few themes are worth remembering in reviewing the work done by the authorities. These represent general background considerations and also challenges both the authorities and market participants will have to work through in understanding the new landscape. Each of the below will be a source of uncertainty and possible unintended consequences:

- **Increased complexity:** Going from a single piece of legislation (admittedly with various technical standards) to three overlapping sets of rules in an SI, PRA rules and FCA rules will inevitably create complexity, regardless of the skill with which the move to the new system is carried out. Not only do the regulator-made rules need to mesh with the SI, they also need to mesh with each other. The additional complication of occupational pension schemes ("**OPS**") having due diligence rules imposed by SI but supervised by The Pensions Regulator introduces yet further complexity.
- **"Coherent" rules are not "identical" rules:** Further, the FCA and PRA (and the SI, in the case of OPS due diligence rules) have taken different approaches to transferring the rules to their rulebooks, as described above. While we agree that the HSD-style formulation is frequently easier to understand than the UK Securitisation Regulation text, we can't help but think it is regrettable that the authorities could not agree a common text that they would both (or all, in the case of due diligence rules which also appear in the SI) adopt so that the rules are all worded identically.
- **Firm-facing rules vs. non-firm-facing rules:** A challenge legislation need not contend with is the separation between firm-facing rules vs. other rules (e.g. rules that bind regulators). The regulators and the Government have clearly had to spend time considering where each rule should go and the form in which it should be carried over to the new structure. The regulators only have power to impose rules on firms, and not e.g., on themselves. Even the SI is limited by the Financial Services and Markets Act 2023 ("**FSMA 2023**") in what powers and duties it can impose. There have clearly been places where the existing rules fit awkwardly into the new structure, such as the ban on resecuritisation, meaning that the new rules look quite different to the UK Securitisation Regulation. Even where there is no policy intention to make a new rule, it remains to be seen whether the authorities have achieved this outcome with their drafting.
- **A collapsed structure:** Historically, there has been a clear hierarchy of sources of law, with the UK Securitisation Regulation at the top, followed by technical standards, regulator guidance (e.g. Q&A documents) and

market practice. As far as firm-facing rules are concerned, the current UK Securitisation Regulation and the technical standards will now be collapsed into a single level of regulator rules. To the extent firms have historically relied on the text of the UK Securitisation Regulation overriding the text of any technical standards, they will now need to rethink this with their advisers, since this argument will no longer be available.

- **Recitals removed:** In the recasting process, the recitals in the EU legislation have been removed. In principle, the recitals of EU legislation are not meant to be operative so this should have minimal effect, but experienced market participants will know that recitals are frequently used as a legislative fudge that then becomes crucial in practice. Reviewing the draft regulator rules, it is clear that they have to some extent incorporated "operative" recitals into the new rules (e.g., the trade receivables exemption from the requirement to check credit granting standards), but it is not clear whether this has been done in every situation market participants might like.
- **General rules of interpretation:** Beyond all of the textual changes, market participants also need to consider the effect of changes to the general legal context and rules of interpretation. Unlike EU law, which favours purposive interpretations, the new rules are domestic UK law, which places much greater emphasis on the words on the page. This, in turn, leaves much less room for market participants (or indeed regulators) to construe the rules in the context of what they are trying to achieve.

Next steps

The Government has invited feedback on its near-final SI by 21 August 2023, so that should clearly be the priority ahead of the 30 October 2023 deadline for both the PRA and the FCA consultations. That said, there is a very large volume of complex material to get through, and a significant chunk of the time before the regulators' deadline overlaps with summer holidays. We would therefore urge market participants to begin their consideration of the proposals as soon as possible in order to provide meaningful, helpful feedback that will encourage the authorities to produce workable rules for the market going forward.

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