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Article

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EU New Securitisation Framework For Non-EU Issuers

Highlights

Since the new European Union securitisation framework came into effect, further debate around Article 7 transparency requirements and the European Securities and Markets Authority templates' applicability to non-EU issuers followed around the world. The application of these requirements to non-EU transactions is ambiguous and open to interpretation. Ongoing advocacy efforts might bring clarification on the matter and improvements to the regulation.

Non-EU issuers are not obliged to comply with the EU framework if they are not located in the EU and their EU institutional investors do not have exposure in transactions issued by them. However, non-EU issuers that want access to EU investors are concerned about their ability to comply with some aspects of the new regulation, as the disclosure of information can differ from what they are now subject to depending on each local regulator.

In this report, Moody's Analytics brings attention to two of the main concerns arising from non-EU market players in regards to the EU new securitisation framework:

- Interpretations of Article 7
- Details on some key requirements and its effect on non-EU issuers that are willing to have their deals offered/funded by EU institutional investors

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The Article 7 Dilemma

Article 7 defines disclosure and reporting requirements under the new European securitisation regulation and it is mandatory for EU transactions. It ties up with Article 5(1)—which determines the EU institutional investors due diligence obligations—and that is where the interpretive issue lies: Must non-EU transactions comply with Article 7 transparency rules or not?

Article 5(1)(e) states that institutional investors must verify that "an originator, sponsor or issuer has, where applicable, made available the information required by Article 7." The use of "where applicable" has brought divergent views on the applicability of the requirement to non-EU transactions. Uncertainty lingers even when market participants assume Article 7 would apply to non-EU transactions. Should Article 7 then be followed entirely, including form and content of reporting, or should non-EU issuers only provide to investors enough information to complete their due diligence requirements as per Article 5 and not necessarily comply with the ESMA templates?

None of the above has been clarified, creating a lot of hesitation in the market on which approach to take. Guidance has been requested from the authorities, but this process will take time and the regulation has already been promulgated. Until that happens, EU investors have to make sure they request all the necessary information required to give them the comfort that they will be in a position to demonstrate good faith and due diligence should they be questioned by regulators. Non-EU originators have to keep in mind that the closer they are to fully complying to the new EU framework, the easier it will be to access the EU market. It should be a choice between making their transactions appealing to investors to acquire, hold and/or transfer or avoiding the operational challenges associated with following the EU securitisation regulation.

Framework Application for non-EU Issuers

The new European Union securitisation framework puts market participants—issuers and investors—through an extensive list of obligations. In general, these obligations are only mandatory if the relevant entity is established in the EU. Rules also fully apply to all branches and affiliates of EU banks and investment firms on a consolidated basis—including risk retention, transparency and due diligence, as explained below.

There are six main areas of interest regarding the new European framework, related to key general requirements and how they will apply to non-EU issuers:

	DIRECT application to non-EU entity	INDIRECT application to non-EU entity
Investor Due Diligence	If consolidated entity with EU bank	Not relevant
Credit Granting Standards	If consolidated entity with EU bank	Yes, if seeking access to EU investors
Self-Certified Loan Restriction	If consolidated entity with EU bank	Unclear, but probably should not apply
Risk Retention	If consolidated entity with EU bank	Yes, if seeking access to EU investors
Adverse Selection	If consolidated entity with EU bank	No
Disclosure and Reporting	If consolidated entity with EU bank	Not expected, but could apply via investor DD

Investor Due Diligence

Under the Securitisation Regulation, institutional investors will need to have, and observe, clearly defined criteria and processes for making investment decisions and ensuring that the risk-retention requirement is satisfied. They will also need to monitor asset performance and have a comprehensive and thorough understanding of the securitisation investments made and its management. This doesn't have any relevant application to non-EU issuers, as it is an investor obligation, but due diligence provisions will indirectly affect non-EU issuers offering their deals to EU institutional investors since their due diligence has to comply with the EU framework.

Credit Granting Standards

Refers to how entities grant credits:

- Same criteria apply across securitised /non-securitised assets
- Sound and well-defined process for credit approval
- Effective process in place to assess obligor creditworthiness

It's still unclear what level of information will be considered relevant and necessary for verification. Since this can be considered part of the investors' due diligence process, non-EU issuers should be ready to provide this type of clarification if they are willing to seek access to European investors.

Self-Certified Loan Restriction

Residential mortgage-backed securities backed by loans that are "marketed and underwritten on the premise that the loan applicant or, where applicable, intermediaries were made aware that the information provided by the loan applicant might not be verified by the lender" are banned. However, the ban applies only to EU transactions issued after January 1, 2019 and to underlying loans originated after the Mortgage Credit Directive in March 2016.

Risk Retention

The purpose of risk retention is to have aligned interests between originators and investors regarding securitisation deals. While risk retention key provisions remain the same under the new regime, the onus is on investors to ensure that requirements are satisfied. Originators and sponsors could face myriad administrative, or even criminal, sanctions depending on how the regulation is implemented in each EU country. Like many of the points described here, this is not mandatory for non-EU issuers unless a similar regulation applies in their countries, but will be required by European investors as a criteria/requirement for their investment decisions.

Adverse Selection

The selection of the underlying exposures shall be random, based on the eligibility criteria defined in the transaction documents, and shall have similar characteristics to the ones left on the originator balance sheet (no "cherry-picking"). There is an exception for non-performing loan deals. Because this is part of the simple, transparent and standardised regime, it should not apply to non-EU originators.

Disclosure and Reporting

The new EU regulatory framework defines a detailed disclosure and reporting obligations for EU entities on a pre-deal and ongoing basis. Required information extends to loan-level data, investor reports, transaction documents, inside information, and, for private deals, transaction overview. Standard templates have already been published by regulators. From a non-EU issuers' perspective, there are a lot of discussions going on as some of the data required relate to EU markets specificities. Non-EU market participants are reluctant to follow the ESMA templates, but they understand that complying facilitates their access to the European investor base.

Conclusion

Although most of new regime is mandatory for the EU market and securitisation issuers and sponsors only, it cannot be ignored if EU investor access is desirable. Regulators have already been questioned about whether these rules will or should be extended to non-EU entities, as credit institutions and investment firms will benefit from favourable capital treatment of their securitisation exposures under the STS label.

Moody's and its team of securitisation experts are keeping a close eye on future developments from European regulators and look forward to actively working with and supporting our clients in taking an informed and pragmatic approach towards a decision of fully complying or not with the new EU regulatory framework.

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