"Onshoring" Statutory Instruments Comment Series: Securitisation

March 2019

www.fmlc.org

Financial Markets Law Committee[1]

This paper has been prepared by the FMLC Secretariat[2] and incorporates substantive comments from the following:

Andrew Bryan	Clifford Chance LLP
Sean Renfer	Sidley Austin LLP

[N.B.: In order to aid the reader, the FMLC has clarified here the use of certain typographical cases in references throughout this paper. References to one or more "Regulation[s]" are to the relevant E.U. legislation and U.K. statutory instruments (as applicable), whereas references to "regulations" are to individual provisions of statutory instruments. References to "Articles" are to individual provisions of E.U. Regulations. References to a "Third Country" are references to this concept as used under E.U. treaties and legislation, whereas references to a "third country" are references to this concept as used under U.K. legislation.]

1 In view of the role of the Bank of England, the Financial Conduct Authority and HM Treasury in the U.K.'s preparations for withdrawal from the E.U., Sinead Meany, Sean Martin and Peter King took no part in the preparation of this paper and the views expressed should not be taken to be those of the Bank of England, the FCA and HM Treasury.

2 Joanna Perkins (FMLC Chief Executive) and Clare Wiles (FMLC Legal Analyst).

TABLE OF CONTENTS

1. EXECUTIVE SUMMARY AND INTRODUCTION

1.1. The role of the Financial Markets Law Committee (the "**FMLC**" or the "**Committee**") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks and to consider how such issues should be addressed.

1.2. In June 2016, the U.K. voted by way of an in/out referendum to withdraw from the European Union (known colloquially and in this paper as "**Brexit**"). In the years since the referendum, negotiations between the U.K. and E.U. have focused on agreeing a Withdrawal Agreement and a plan for a future relationship in time to ensure an orderly Brexit on the date on which the U.K. is scheduled to withdraw from the E.U. ("**Exit Day**").[3] Since the Withdrawal Agreement has not been approved by Parliament, preparations in the U.K. have focused on a "no deal" eventuality.

1.3. A key element in HM Government's plan to ensure continuity in law during and after Brexit in the U.K. is the European Union (Withdrawal) Act 2018 (the "**Withdrawal Act**") which aims, *inter alia*, to incorporate into U.K. law all applicable E.U. legislation and to give powers to Ministers to make such amendments to retained law as are necessary to deal with any deficiencies arising from withdrawal.[4] In furtherance of these aims, HM Treasury has begun to publish drafts of statutory instruments ("**SIs**") which will "onshore" E.U. legislation related to the financial markets.[5]

1.4. This paper considers legal uncertainties arising from the changes proposed by the draft Securitisation Amendment (EU Exit) Regulations 2019 (the "**draft Securitisation SI**"). As with all the SIs published pursuant to the aims of the Withdrawal Act, the FMLC understands that the draft Securitisation SI has been laid before Parliament with the intention of implementing a policy position arising from a "no deal" Brexit. The

---

3 This date was originally 29 March 2019, set in accordance with the end of the two-year "notice" and negotiation period which was triggered by the U.K. under Article 50 of the Treaty on European Union on 29 March 2017. Legislative provisions defining Exit Day as 29 March 2019 can be found in the European Union (Withdrawal) Act. Section 20(4) of that Act gives a Minister of the Crown the power to amend the definition of Exit Day so that it correctly refers the day on which the E.U. Treaties cease to apply to the U.K. An extension to the Article 50 notice period was granted by the E.U. such that the U.K. is scheduled to leave on 12 April 2019, if the Withdrawal Agreement is not approved by Parliament, or 22 May 2019 if the Withdrawal Agreement is accepted. The definition of Exit Day has been amended accordingly by the European Union (Withdrawal) Act 2018 (Exit Day) (Amendment) Regulations 2019.

4 Text of the European Union (Withdrawal) Act 2018 is available at: http://www.legislation.gov.uk/ukpga/2018/16/pdfs/ukpga_20180016_en.pdf.

5 A list of the statutory instruments published in relation to the financial services, included those which have been put before Parliament for approval, can be found on the following webpage: HM Government, *Financial services legislation under the EU (Withdrawal) Act 2018,* (first published 9 August 2018), available at: https://www.gov.uk/government/collections/financial-services-legislation-under-the-eu-withdrawal-act?utm_source=ed3e24c1-615b-4397-a940-f10eb4c57fcd&utm_medium=email&utm_campaign=govuk-notifications&utm_content=immediate.

Committee does not comment on matters of policy or the form that future regulatory approaches, if any, should take and this report should not be understood to constitute comments thereon. Nevertheless, the Committee has drawn attention to some legal and operational uncertainties which will arise in a "no deal" context in which it is anticipated the draft Securitisation SI will be implemented.

2. BACKGROUND

2.1. The purpose of the draft Securitisation SI is to ensure that the new securitisation regime, as set out in Regulation (EU) 2017/2402 laying down a general framework for securitisation and creating a specific framework for simple, transparent and standardised securitisation (the "**Securitisation Regulation**"), and which took effect in the U.K. from 1 January 2019, continues to operate effectively in the U.K. following Exit Day in the event of a no deal Brexit. To this end, the draft Securitisation SI makes various amendments to correct deficiencies in retained E.U. law (including the Securitisation Regulation and associated legislation), and existing U.K. law which relates to securitisation. References in this paper to the "Onshored Securitisation Regulation" are references to the onshored version of the Securitisation Regulation as amended by the draft Securitisation SI.

2.2. Securitisation refers to the process of transforming loans into tradable financial assets (securities), which can be sold on to investors. A typical securitisation involves an originator, a securitisation special purpose entity ("**SSPE**") and/or a sponsor. The originator packages pools of assets and sells them to the SSPE, which serves as the investment vehicle in the securitisation. The sponsor is a credit institution or investment firm that establishes and manages an asset-backed securities or asset-backed commercial paper ("**ABCP**") programme or other securitised scheme from third parties.

2.3. The Securitisation Regulation reforms and harmonises E.U. rules regarding securitisation, particularly with respect to due diligence, risk retention, disclosure and credit granting. The Securitisation Regulation also introduces a new regulatory framework for simple, transparent and standardised ("**STS**") securitisations: securitisation transactions that qualify as STS securitisations may be able to obtain preferential capital treatment under the Securitisation Regulation.

3. LEGAL UNCERTAINTIES AND IMPACT

Legislative References

3.1. The Securitisation Regulation contains numerous cross-references to E.U. legislation. The draft Securitisation SI, like other onshoring SIs, adopts a variety of approaches to freezing these cross-references to E.U. law at various points in the future. This includes, for example, a cross reference to a provision in an E.U. Regulation which has been onshored by a different piece of domestic secondary legislation. For instance, regulation 20(2) of the draft Securitisation SI amends Article 20(8) of the Securitisation Regulation to insert a reference to Regulation (EU) 600/2014 on markets in financial instruments ("**MiFIR**"). Regulation 20(2) is followed by a footnote which indicates that the definition of "transferable securities" has been updated by S.I. 2018/1403, i.e. the Markets in Financial Instruments (Amendment) EU Exit) Regulations 2018. The implication, then, is that regulation 20(2) is referring to the onshored version of MiFIR. In other places, the draft Securitisation SI similarly inserts references to E.U. legislation such as the CRR and Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories ("**EMIR**") without any mention of the SIs which onshored them.[6] This, the FMLC understands is an incorporated reference to E.U. legislation as it will stand immediately before Exit Day, enabled by provisions of the Withdrawal Act and, in particular, Schedule 8 of that Act. Notably, Schedule 8(1)(1)(b) provides that references to "any EU regulation, EU decision, EU tertiary legislation or provision of the EEA agreement as it forms part of domestic law by virtue of section 3" ("**Retained Direct E.U. Legislation**") are references to that measure as it shall have effect immediately before Exit Day.[7] On or after Exit Day, however, references to such Retained Direct E.U. Legislation are references to that measure as it forms part of domestic (U.K.) law and (unless otherwise stated) as it is modified by domestic law from time to time.[8] The onshoring regime is, however, creating a vast and complex body of legislation with amendments peppered across multiple pieces of legislation. In this context, the FMLC considers that it would be helpful to have an expressly clear,

---

6 See, for example, the definition of "sponsor" in Article 2(5) of the Securitisation Regulation as amended by regulation 4(3) of the draft Securitisation SI. This is different from instances at which the draft Securitisation SI refers to definitions or provisions which have been created by the body of onshoring secondary legislation and which, therefore, can only be found in the onshored versions of E.U. Regulations. An example of such a reference can be found in regulation 4(4)(c)(g) which inserts into the definition of "institutional investor" a reference to a "CRR firm" which is a concept created by regulation 64(3) of The Capital Requirements (Amendment) (EU Exit) Regulations 2018.

7 Note that "retained direct EU legislation" is defined in the Withdrawal Act to mean any direct EU legislation which forms part of domestic law by virtue of section 3. Schedule 8(1)(1) of the Withdrawal Act sets out the grandfathering provisions for such measures.

8 Schedule 8(1)(1) of the Withdrawal Act.

consistent approach in the draft Securitisation SI regarding references to other E.U. legislation.

3.2. The FMLC also notes that the draft Securitisation SI onshores and amends the Delegated Regulation (EU) 2015/61 (the "**Liquidity Commission Delegated Regulation**"). The FMLC understands, however, that the European authorities plan to amend this legislation in due course such that only STS securitisations may qualify as Level 2B securitisations under the Liquidity Commission Delegated Regulation.[9] As these amendments will not come into force until after Exit Day (and so after the U.K. onshoring), this means that there will be a divergence between the U.K. and E.U. approach to interpreting the scope of Level 2B securitisations. To avoid market uncertainty, HM Treasury may wish to consider whether the U.K. approach should be aligned with the E.U. approach and whether the onshored Liquidity Commission Delegated Regulation should be reviewed in accordance with E.U. legislative changes.

Geographical Scope

Scope of the STS Securitisation Market

3.3. The FMLC notes that the draft Securitisation SI narrows the geographical scope of securitisations in various ways. For instance, regulation 18(c) of the draft Securitisation SI restricts the place of establishment of the originator and sponsor of an STS securitisation to the U.K. Regulations 43 and 50 of the draft Securitisation SI also amend the CRR Amending Regulation by placing various geographical restrictions on entities, which in turn may limit the extent to which synthetic securitisations of small and medium enterprises ("**SME**") exposures can benefit from STS treatment.[10] As a general comment, the FMLC notes that these and other similar amendments with respect to geographical scope may cause transitional issues and potentially reduce the size of the STS securitisation market in the U.K.

3.4. This restrictive approach to geographical scope may also cause particular uncertainty with respect to the risk retention requirement for securitisations. This is discussed in further detail below.

---

9 The European proposal is published in the Official Journal of the E.U., available online: https://eur-lex.europa.eu/legal-content/CS/ALL/?uri=PI_COM:Ares(2018)418078.

10 Article 270 of the CRR Amending Regulation currently provides that the senior position in certain synthetic securitisations of SME can to benefit from STS treatment, provided that certain conditions are met. One of the conditions is that the transferred credit risk must have been transferred to "the central government or the central bank of a Member State, a multilateral development bank, an international organisation or a promotional entity, provided that the exposures to the guarantor or counter-guarantor qualify for a 0 % risk weight under Chapter 2". Article 50 of the draft Securitisation SI amends this condition to refer to "the central government or the central bank *of the U.K.*" (emphasis added), and Article 43 also limits the scope of a "promotional entity" to entities established in the U.K.

Risk Retention

3.5. Article 6(1) of the Securitisation Regulation provides that the

> originator, sponsor or original lender of a securitisation shall retain on an ongoing basis a material net economic interest in the securitisation of not less than 5 %.

Article 6(4) in turn provides that an originator, sponsor or original lender can rely on the consolidated situation of a parent institution, financial holding company or mixed financial holding company established in the Union, where this entity, as an originator or sponsor, securitises exposures from one or more credit institutions, investment firms or other financial institutions which are included in the scope of supervision on a consolidated basis. Effectively, then, a U.K. originator may not need to meet the Article 6(1) obligation if it can rely on its E.U. parent institution meeting the Article 6(4) retention requirement instead.

3.6. However, regulation 8(3) of the draft Securitisation SI amends this Article 6(4) requirement, such that an originator, sponsor or original lender can rely on the consolidated situation of a *U.K.* parent institution. This could, therefore, create transitional issues for a U.K. originator, sponsor or original lender that was relying on retention on a consolidated basis by its E.U. parent institution prior to the U.K.'s withdrawal from the E.U. The question arises as to whether the U.K. originator, sponsor or lender could continue to rely on retention by its E.U. parent institution for any period of time following a no deal Brexit, and if not, what measures this U.K. entity should take instead.

3.7. Such transitional issues may also impact U.K. institutional investors who, pursuant to Article 5(1)(c) of the Securitisation Regulation, are required to verify that an originator, sponsor or original lender, established in the Union, both meets the Article 6 retention requirements discussed above and discloses this to the institutional investor in accordance with Article 7 of the Securitisation Regulation. Regulation 7(2)(a) of the draft Securitisation SI amends this due diligence requirement such that U.K. institutional investors must perform due diligence on *U.K.*-established originators, sponsors or original lenders. It is unclear how this amendment would affect a U.K. institutional investor who, in making its investments pre-Brexit, was relying on due diligence performed on an E.U.-established originator, sponsor or original lender. It is moreover unclear whether such a U.K. institutional investor could continue to rely on such due diligence for any period of time following a no deal Brexit.

References to European standards

3.8. The Securitisation Regulation, as amended by the draft Securitisation SI, continues to refer in a handful of places to both "living" and "frozen" E.U. requirements and standards, embedded in E.U. Directives, which might seem incongruous and confusing in respect of the U.K. market.

3.9. As noted in paragraph 3.1 of this paper, pursuant to Schedule 8(1)(1) of the Withdrawal Act, references to Retained Direct E.U. Legislation are effectively "frozen" immediately before Exit Day, and on and after Exit Day, should be read as references to the onshored versions of such measures. This Schedule 8(1)(1) grandfathering rule applies specifically to E.U. Regulations, Decisions and Tertiary Legislation. It does not, however, appear to extend to E.U. Directives.[11] Nevertheless, Schedule 8(2)(1) of the Withdrawal Act appears to apply a similar grandfathering rule to E.U. Directives, albeit with a different rule for reading references on and after Exit Day. Schedule 8(2)(1) provides, *inter alia*, that any reference which, immediately before Exit Day, exists in any Retained Direct E.U. Legislation and refers to any "EU instrument" is to be read, on or after Exit Day, as a reference to that instrument as it had effect immediately before Exit Day. The Securitisation Regulation will be an instance of Retained Direct E.U. Legislation, and so the question arises whether E.U. Directives referenced within it fall within the scope of "EU instruments" under this Schedule 8(2)(1) grandfathering provision. Based on the interpretative provisions of the Withdrawal Act, it is strongly arguable that E.U. Directives do constitute such "EU instruments". Section 21 of the Withdrawal Act provides that the term "EU instrument" should be interpreted in accordance with Schedule 1 to the Interpretation Act 1978. Schedule 8(22) of the Withdrawal Act in turn makes amendments to Schedule 1 of the Interpretation Act 1978, including by inserting the following definition of an "EU instrument": "any instrument issued by an EU institution other than any retained direct EU legislation." Although the point is not made expressly clear, the definition of an "EU instrument" appears broad enough to encompass E.U. Directives and the provisions contained therein (particularly since the definition expressly excludes E.U. Regulations, Decisions and Tertiary Legislation). Following this interpretation, then, references to E.U. Directives in the Onshored Securitisation Regulation would be "frozen" immediately before Exit Day and, on and after Exit Day, should continue to be read as references to the E.U. Directives as they had effect immediately before Exit Day.

11 Under the Withdrawal Act, "EU tertiary legislation" includes any provision made under an E.U. directive, by virtue of Article 290 or 291(2) of the Treaty on the Functioning of the European Union (which allow for the provision of delegated and implementing acts). It does not, however, include any such provision or measure which is an E.U. directive.

3.10. Assuming that this is the U.K.'s intended approach to grandfathering references to E.U. Directives, it raises various issues of uncertainty when one examines certain cross-references to E.U. Directives that will be maintained in the Onshored Securitisation Regulation. Specific examples where such uncertainty arises are analysed below.

3.11. One example is within Article 20 of the Securitisation Regulation which sets out the simplicity requirements a non-ABCP securitisation must meet in order to be designated an STS securitisation. Article 20(10) of the Onshored Securitisation Regulation will state in sub-paragraph three:

> The assessment of the borrower's creditworthiness shall meet the requirements set out in Article 8 of Directive 2008/48/EC or paragraphs 1 to 4, point (a) of paragraph 5, and paragraph 6 of Article 18 of Directive 2014/17/EU or, where applicable, equivalent requirements in third countries.

3.12. Therefore, following the grandfathering approach set out in paragraph 3.9 above, the reference to "Article 8 of Directive 2008/48/EC or paragraphs 1 to 4, point (a) of paragraph 5, and paragraph 6 of Article 18 of Directive 2014/17/EU" should be construed as a reference to these provisions as they had effect in Directive 2008/48/EC on credit agreements for consumers (the "**Consumer Credit Directive**") and Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property (the "**Mortgage Credit Directive**") (together, the "**E.U. Consumer Directives**") *immediately before Exit Day*.

3.13. This reading raises various issues of uncertainty, in particular the following:

- It is unclear why Article 20(10) of the Onshored Securitisation Regulation refers to these provisions of the E.U. Consumer Directives and not to the U.K. implementing legislation of such Directives. Article 8 of the Consumer Credit Directive and Article 18 of the Mortgage Credit Directive both set out obligations for creditors to assess the creditworthiness of the consumer. The FMLC is aware, however, that the Article 8 of the Consumer Credit Directive has been implemented in U.K. law *via* section 55A of the Credit Consumer Act 1974 (as amended);[12] additionally, the FCA has implemented Article 18 of the Mortgage

[12] See section 4.3 of the FCA's Consultation Paper 17/27, available online: https://www.fca.org.uk/publication/consultation/cp17-27.pdf.

Article 55A was inserted into the Consumer Credit Act 1974 by the Consumer Credit (EU Directive) Regulations 2010 (S.I. 2010/1010).

Credit Directive into the Mortgages and Home Finance: Conduct of Business sourcebook ("**MCOB**"), specifically in MCOB 11.6 and 11A.3. It therefore seems odd that Article 20(10) should refer to E.U. standards for creditworthiness assessments (as frozen immediately before Exit Day), instead of referring the relevant transposed standards under U.K. law (as these will be amended from time to time).

- It is also unclear why the additional phrase "or, where applicable, equivalent requirements in third countries" should be included in Article 20(10) of the Onshored Securitisation Regulation in that form. Following a no deal Brexit, under which HM Government would designate E.U. Member States as "third countries", this phrase could be read as saying that U.K. assessments of a borrower's creditworthiness must meet, where applicable, equivalent requirements in *E.U. Member States*; presumably, this could include requirements under the E.U. Consumer Directives as amended from time to time by E.U. legislative processes. It seems odd to give U.K. market participants the option to apply ongoing E.U. standards to creditworthiness assessments, when the first half of Article 20(10) already freezes such standards as they had effect immediately before Exit Day. The inclusion of this additional phrase creates the risk that U.K. market participants could adopt diverging approaches when performing creditworthiness assessments.

3.14. More generally, the application of E.U. standards to U.K. market participants under Article 20(10) seems inadvertent, particularly when one considers other amendments to the regime in the Securitisation Regulation for the designation of STS, which clearly provide that this should be a U.K.-based and regulated regime. For instance, amendments to Article 18 by regulation 18(c) of the draft Securitisation SI provide that the FCA may only grant an STS designation to securitisations which involve sponsors and originators established in the U.K. who, it might be expected, will be originating loans to U.K. consumers. The FMLC therefore wonders whether the cross-references in Article 20(10) should be to the relevant U.K. implementing provisions discussed in paragraph 3.13 above, instead of to the E.U. Consumer Directives.

3.15. Another place in the Onshored Securitisation Regulation where a similar uncertainty is present is Article 25(3) (*Sponsor of an ABCP programme*) which provides that a credit institution must demonstrate to the FCA that its role as a sponsor of an ABCP programme does not endanger its solvency and liquidity. In its assessment, the FCA is required to refer to the basis of the review and evaluation referred to Article 97(3) of Directive 2013/36/EU on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms (the "**Capital Requirements Directive**"). This would mean that E.U. requirements (as frozen immediately before Exit Day) will continue to apply to U.K. STS designations, even if U.K. standards diverged from such E.U. requirements over time.

3.16. To avoid such potential uncertainty and the ensuing market consequences, the FMLC wonders if HM Treasury might consider an approach which refers to measures in domestic law which have implemented the requirements of these Directives. For instance, in the Bank Recovery and Resolution and Miscellaneous Provisions (Amendment) (EU Exit) Regulations 2018, regulation 47(h)(i) inserts a reference to the Capital Requirements Directive using the following phrase, which could be duplicated in Article 25(3) of the Onshored Securitisation Regulation (and indeed modified accordingly in Article 20(10)):

> the requirements relating to capital or liquidity imposed by or under legislation upon which the United Kingdom relied immediately before exit day to meet its obligations with respect to the capital requirements directive.

Due Diligence Requirements for Institutional Investors

3.17. The draft Securitisation SI further amends various due diligence requirements for institutional investors that hold a securitisation position. Various uncertainties may arise as a result of these amendments, and these are discussed below.

Transparency Requirements

3.18. Article 5 of the Securitisation Regulation sets out the due diligence requirements for institutional investors. Articles 5(1)(a)-(e) in turn list five points that an institutional investor (other than the originator, sponsor or original investor) must verify prior to holding a securitisation position. By way of example, Article 5(1)(e) requires institutional investors to verify that:

> the originator, sponsor or SSPE has, where applicable, made available the information required by Article 7 in accordance with the frequency and modalities provided for in that Article.

Article 7 in turn lists the transparency requirements for the originator, sponsor and SSPE of a securitisation.

3.19. The draft Securitisation SI amends Article 5(1) by inserting limb (f), which sets out a sixth point that institutional investors must verify prior to holding a securitisation position:

> (f) if established in a third country, the originator, sponsor or SSPE has, where applicable—
>
> > (i) made available information which is substantially the same as that which it would have made available in accordance with point (e) if it had been established in the United Kingdom; and
> >
> > (ii) has done so with such frequency and modalities as are substantially the same as those with which it would have made information available in accordance with point (e) if it had been so established.

3.20. This new limb (f) therefore requires U.K. institutional investors under the Onshored Securitisation Regulation to ensure that a "third country" originator, sponsor or SSPE has disclosed substantially the same information as a U.K. originator, sponsor or SSPE would have to disclose under Article 7 of the Securitisation Regulation. A "third country" is defined in the draft Securitisation SI as "a country other than the United Kingdom". Therefore, this limb (f) covers situations where a U.K. institutional investor is dealing with any non-U.K. (i.e. E.U. or non-E.U.) originator, sponsor or SSPE.

3.21. Where the U.K. institutional investor is dealing with an E.U. originator, sponsor or SPV, the E.U. entity will already be subject to Article 7 of the Securitisation Regulation and so, by necessity, will need to meet the two requirements under limb (f). Therefore, this should not raise any further difficulties for the U.K. institutional investor's due diligence obligations.

3.22. This new limb (f) does provide that, in order to invest in a securitisation involving non-E.U. originators, sponsors and SSPEs, a U.K. institutional investor must verify that such entities are providing information which is "substantially the same" to that provided under Article 7. There is, however, uncertainty as to how "substantially the same" information may be judged. Clarification from the FCA and PRA on the meaning of "substantially the same" information would be useful, especially in light of the market consequences that could arise from such uncertainty. Such potential consequences are briefly discussed below.

3.23. In particular, uncertainty surrounding the "substantially the same" information requirement may cause difficulties for U.K. institutional investors where they are investing in securitisation positions issued by originators, sponsors or SSPEs established outside of the E.U. By way of example, it could be argued that limb (f) would mean that a U.K. investor in a U.S. commercial mortgage-backed security deal must require the U.S. originating bank to make E.U.-style disclosures. The FMLC understands from market experts that U.S. banks are typically not set up to make such disclosures, and so the U.K. investor could find itself unable to fulfil this due diligence requirement. Clarification regarding the scope of this "substantially the same" information requirement would help remove potential uncertainty and the possible consequences thereof.

Due Diligence of STS Status

3.24. Article 5(3) of the Securitisation Regulation requires that an institutional investor (other than the originator, sponsor or original lender) must, prior to holding a securitisation position, carry out a due-diligence assessment which enables it to assess the risks involved.

3.25. One of the three factors that the institutional investor's assessment must consider is:

> with regard to a securitisation notified as STS in accordance with Article 27, the compliance of that securitisation with the requirements provided for in Articles 19 to 22 or in Articles 23 to 26, and Article 27. Institutional investors may rely to an appropriate extent on the STS notification pursuant to Article 27(1) and on the information disclosed by the originator, sponsor and SSPE on the compliance with the STS requirements, without solely or mechanistically relying on that notification or information.

3.26. Regulation 7(3) of the draft Securitisation SI amends this requirement in Article 5(3) such that

> the reference to a securitisation notified as STS in accordance with Article 27 includes a reference to a securitisation notified in accordance with that Article before exit day, or before the expiry of a period of two years

beginning with exit day, where the person responsible for the notification (the originator and sponsor or, in the case of an ABCP programme, the sponsor) is established in an EEA State.

3.27. Therefore, it appears that U.K. institutional investors can treat E.U. STS transactions as STS—until maturity—under the Onshored Securitisation Regulation *provided that* the E.E.A. person responsible for the STS notification made such a notification in accordance with Article 27 either (i) before Exit Day, or (ii) before the expiry of a period of two years beginning with Exit Day.

3.28. The FMLC would welcome clarification that this is indeed the intention of the draft Securitisation SI, and that if criteria (i) or (ii) are met, the E.U. STS transactions can still be treated as STS until maturity for U.K. purposes. Moreover, if this is the intention of the draft Securitisation SI, then clarification regarding this point may also be needed in other Regulations that similarly grant preferential treatment to STS securitisations (such as the regulatory capital treatment for STS securitisations under the CRR, as set out in the CRR Amending Regulation).

<u>Third Party Verifiers of STS Status</u>

3.29. Article 27 of the Securitisation Regulation provides that the originator, sponsor or SSPE may use the service of a third party authorised by the "competent authority" to verify whether a securitisation meets various requirements for STS status. The draft Securitisation SI amends this provision such that the third party must be authorised by the FCA. Where entities have been relying on E.U.-authorised third parties to verify STS status, this raises transitional issues as to the ongoing validity of such verifications following a no deal Brexit. It is not clear, for example, whether such verifications would remain valid for a transition period or not, or whether entities could rely on due diligence based on such certifications (or whether they would need to enlist the services of an FCA-authorised third party to re-verify the STS status of the securitisation). Clarification on this point would be welcome.

<u>Institutional Investor Delegates</u>

3.30. Under Article 5(5) of the existing Securitisation Regulation, an institutional investor may delegate its due diligence obligations to another institutional investor. Regulation 4(4) of the draft Securitisation SI, however, amends the definition of an "institutional investor". It is possible that, as a result of these amendments, a delegate that previously met the definition of an "institutional investor" under the existing Securitisation

Regulation would cease to constitute an "institutional investor" under the Onshored Securitisation Regulation. This engenders uncertainty as to whether a delegate who met the definition of an "institutional investor" pre-Brexit could still validly fulfil its delegated obligations for any period of time following a no deal Brexit. It also raises a question as to the consequences for the institutional investor who previously relied on this delegation, if such a delegation ceased to be valid upon Brexit. The FMLC would welcome clarification as to whether such delegations would remain valid following a no deal Brexit, and if so, for how long (e.g. for the length of their mandate or for a certain transition period).

Securitisation Repositories

3.31. Article 10 of the Securitisation Regulation states that a securitisation repository—an entity that centrally collects and maintains records of securitisations—must be a legal person "established in the Union" and must register with ESMA. Regulation 12(3) of the draft Securitisation SI amends this requirement, such that a securitisation repository must be a legal person "established in the United Kingdom" and must register instead with the FCA.

3.32. Consequently, where U.K. originators, sponsors and SSPEs have been reporting to an ESMA-registered securitisation repository, it is not clear how they should continue to manage their reporting following a no deal Brexit. For instance, it is unclear whether they would be able to continue reporting to the ESMA-registered securitisation repository for a transitional period, or whether they would need to re-notify their STS transactions to an FCA-registered securitisation repository upon a no deal Brexit. Clarification on this point would be welcome.

Technical Standards and Guidelines

3.33. Article 47 of the Securitisation Regulation refers to regulatory technical standards adopted by the Commission. Regulation 30 of the draft Securitisation SI replaces the reference to "regulatory technical standards adopted by the Commission" with "the FCA and the PRA, acting jointly, have made technical standards pursuant to Article 6(7) of this Regulation". It is not clear, however, that the FCA and PRA technical standards will be in place prior to Exit Day. To ensure the proper functioning of the securitisation market and to avoid uncertainty, the FMLC is of the view that these technical standards should be put in place as soon as possible.

3.34. The FMLC notes that regulations 19 and 21 of the draft Securitisation SI delete references to draft guidelines published by the European Banking Authority (the "**EBA**") with respect to STS transactions and criteria for such transactions. Regulation 31 of the draft Securitisation SI also removes the reference to a requirement on the EBA to publish a report on the feasibility of a specific framework for STS securitisations. The removal of such market practice guidelines has the potential to create uncertainty with respect to the understanding and functioning of the STS market. The FMLC would welcome the development of, and inclusion of a reference to, any similar guidelines to ensure the proper functioning of the U.K. securitisation regime.

4. RECOMMENDATIONS AND CONCLUSION

4.1. In this paper, the FMLC has highlighted legal uncertainties arising from the draft statutory instrument which will onshore the securitisation regime. These uncertainties related to: (i) E.U. legislative references, including cross-references to E.U. Directives; (ii) the geographical scope of the onshored securitisation regime, particularly with respect to the risk retention requirement; (iii) due diligence requirements for institutional investors; and (iv) transitional provisions and guidelines for the U.K. securitisation regime. In view of the substantial work which has evidently gone into drafting the SIs, the FMLC is certain that HM Treasury has already taken into account both the drafting and policy issues highlighted above. The FMLC would, nevertheless, encourage HM Treasury and HM Government to publish, wherever possible, guidance which might enable impacted institutions and investors to begin planning for the future.

FINANCIAL MARKETS LAW COMMITTEE MEMBERS[13]

Lord Thomas of Cwmgiedd (Chairman)

David Greenwald (Deputy-Chairman)

Andrew Bagley, Goldman Sachs International

Sir William Blair, Queen Mary, University of London

Raymond Cox QC, Fountain Court Chambers

Hubert de Vauplane, Kramer Levin Naftalis & Frankel LLP

Michael Duncan, Allen & Overy LLP

Simon Firth, Linklaters LLP

Bradley J Gans, Citigroup

Kate Gibbons, Clifford Chance LLP

Richard Gray, HSBC Bank plc

Carolyn H. Jackson, Katten Muchin Rosenman U.K. LLP

Mark Kalderon, Freshfields Bruckhaus Deringer LLP

Rachel Kent, Hogan Lovells (International) LLP

Peter King, HM Treasury

Sir Robin Knowles CBE

Sean Martin, Financial Conduct Authority

Jon May, Marshall Wace LLP

Sinead Meany, Bank of England

Chris Newby, AIG

Jan Putnis, Slaughter and May

Barnabas Reynolds, Shearman & Sterling LLP

Peter Spires, Lloyd's of London

Sanjev Warna-kula-suriya, Latham & Watkins LLP

Pansy Wong, J.P. Morgan

Mr Justice Zacaroli

Joanna Perkins (Chief Executive)

---

13 Note that Members act in a purely personal capacity. The names of the institutions that they ordinarily represent are given for information purposes only.