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Olivier Guersent
Directorate-General for Financial Stability, Financial Services and
Capital Markets Union
European Commission
1049 Bruxelles/Brussel
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FINANCIAL MARKETS LAW COMMITTEE

Dear M. Guersent

Article 5(1)(e) of the E.U. Securitisation Regulation (the "EUSR")

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.

Article 5(1)(e) of the EUSR 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" (emphasis added).[1] The FMLC understands that the words "where applicable" are a source of significant legal uncertainty as to whether Article 7 applies indirectly to non-E.U. transactions and that the market has so far been unable confidently to settle on a common interpretation thereby resulting in unnecessary legal risks being borne by market participants.[2]

The Committee is of the view that there are at least two plausible interpretations of the words "where applicable" in this context. They are as follows:

(1) On the first interpretation, the words "where applicable" serve as an acknowledgment that not all elements of Article 7 will be relevant to all transactions although verification of full compliance with Article 7 will still be required. So, for example, a transaction summary will not be required pursuant to Article 7(1)(c) if a prospectus has already been drawn up in compliance with the E.U. Prospectus Regulation and, accordingly, there is no need for an institutional investor to require the transaction summary as part of its due diligence exercise.[3]

(2) On the second interpretation, the words "where applicable" serve to limit the scope of the Article 5(1)(e) obligation to those situations where Article 7 is directly applicable to at least one of the originator, the sponsor or the SSPE. So, for example, where all of the originator, sponsor and SSPE are established in a jurisdiction outside of the E.U. (a "**Third Country**") and the transaction has no nexus with the E.U. (other than a possible investment by an E.U. institutional investor), no obligations would arise under Article 5(1)(e) as these Third Country entities are not directly subject to the EUSR.

The Committee takes the view that the second interpretation (the "**Proposed Approach**") offers the more workable approach, on the ground that it accords with historical and established market practice.[4] The first interpretation on the other hand deviates from, and introduces significant changes to, such market practice. If such deviation is intended, the Committee is of the view that it should be made clear and more guidance on compliance will be needed.

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The Proposed Approach would:[5]

(i) require institutional investors to verify—in the case of any E.U.-established originator, sponsor or SSPE—compliance with the specific requirements of Article 7; but

(ii) forgo the need for institutional investors to verify strict compliance with all aspects of Article 7—in particular the requirement to provide disclosure on the templates specified under the Commission Delegated Regulation supplementing Regulation (EU) 2017/2402 of the European Parliament and of the Council with regard to regulatory technical standards specifying the information and the details of a securitisation to be made available by the originator, sponsor and SSPE ("**RTS**")—in the case where all of the originator, sponsor and SSPE are established in a Third Country, on the grounds that they are not subject to European standards in the course of their business.[6] For the avoidance of doubt, this would be without prejudice to other obligations of institutional investors under Article 5 and, in particular, their obligation under Article 5(3) to carry out a due diligence assessment which enables them to assess the risks involved.

The two interpretations would produce substantively different outcomes. The first interpretation would indirectly—i.e. through the agency of institutional investors—include Third Country entities within the scope of the specific disclosure requirements of Article 7 and, in particular, the requirement to provide disclosure on the templates specified under the RTS.[7] The second interpretation would, in effect, release Third Country entities from these requirements, although they would continue to be indirectly subject to other disclosure obligations by virtue of the Article 5(3) due diligence assessment.[8]

If the Proposed Approach is indeed the favoured approach, the Committee considers that official guidance adopting the Proposed Approach would go a long way to promote legal certainty and clarity in this area.[9] It would also be helpful for there to be official guidance on the approach to the due diligence assessments of transactions involving Third Country entities.[10] In other words, clarification as to what a risk-based due diligence assessment (e.g. under Article 5(3)) requires in respect of Third Country entities would be helpful. The Committee is of the view that official guidance in favour of the Proposed Approach and giving clarity on the EUSR's approach to disclosure in respect of Third Country entities could help facilitate investment activity by E.U. institutional investors as it would tend to make available investment options that otherwise would not be considered by investors owing to uncertainty about due diligence requirements.[11]

If the first interpretation is, however, the favoured approach, the Committee considers that clarification as to the applicability of the templates specified under the RTS with respect to Third Country entities and assets would be extremely helpful and would promote legal certainty and clarity.[12]

I and Members of the Committee would be delighted to meet you to discuss the issues raised in this letter. Please do not hesitate to contact me should you wish to arrange a meeting or if you have any questions.

Yours sincerely,

Joanna Perkins

Joanna Perkins
FMLC Chief Executive[13]

[1] Article 7 of the EUSR requires originators, sponsors and SSPEs to disclose certain information in relation to the securitisations with which they are involved.

[2] The FMLC is given to understand that Third Country originators, sponsors and SSPEs wishing to market into the E.U. are receiving conflicting advice about the need to comply with Article 7. Similarly, institutional investors are receiving conflicting advice about the need to verify full compliance with Article 7 in respect of Third Country originators, sponsors and SSPEs. The conflicting advice has resulted for example in some transactions being marketed on the basis that they do not and need not comply with the EUSR and in some other cases institutional investors holding back from investing because of the uncertainty.

[3] The E.U. Prospectus Regulation is the Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the Prospectus to be published when Securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

In this first interpretation, the fact that not all elements of Article 7 will be relevant to all transactions is acknowledged by the reference to "the information **required** by Article 7" (emphasis added), since a transaction summary is not required by Article 7 where a prospectus has been drawn up in compliance with the E.U. Prospectus Regulation.

[4] Historically, prior to the EUSR regime, investors had obligations to verify that they had a proper understanding of the transaction they proposed to invest in, and although these obligations varied slightly depending on the type of institutional investor, they were not overly prescriptive regarding the information that needed to be verified. Investors were therefore allowed to use their judgment to ensure that they had received sufficient information to form a reasoned assessment.

The Proposed Approach has the benefits of allowing the market to function effectively and appropriately by permitting institutional investors to accept slightly different disclosure adjusted to the appropriate circumstances of the originator, sponsor or SSPE (and their assets) while still concluding that they have fulfilled their due diligence obligations under Article 5.

The FMLC is aware that there might be other policy reasons in favour of the Proposed Approach—including greater alignment with some of the objectives of the European Commission's Capital Markets Union (CMU) initiative, which include having a "more diversified financial system" and "giving savers more investment choices"—but these policy reasons are beyond the remit of the FMLC to elaborate.

[5] A bifurcated approach, distinguishing between E.U. and non-E.U. entities in this way, is adopted in Articles 5(1)(a) and 5(1)(b) and Articles 5(1)(c) and 5(1)(d).

[6] The RTS was adopted by the Commission on 16 October 2019 and is available at: https://ec.europa.eu/transparency/regdoc/rep/3/2019/EN/C-2019-7334-F1-EN-MAIN-PART-1.PDF. The RTS is based on the draft regulatory technical standards published and submitted by the European Securities and Markets Authority (ESMA) to the Commission on 31 January 2019 as mandated under Articles 7(3) and 7(4) of the EUSR. The RTS will come into force on the twentieth day following its publication in the Official Journal of the EU.

The Proposed Approach would be more consistent with the Commission's approach to the form of the templates specified under the RTS which do not appear to cater for Third Country entities or assets.

[7] Some fields in the data templates are not designed appropriately for Third Country entities or assets to complete, for example, fields such as RREC10 and RREC11 (relating to the energy performance certificate of a residential property—a requirement of E.U. law which is inappropriate for non-E.U. assets), CRET6 (relating to NACE industry codes—the European implementation of ISIC codes which is inappropriate for non-E.U. entities) and CRPC20 (relating to the classification of a guarantor according to the European System of Accounts known as "ESA 2010" which is difficult for non-E.U. entities to ascertain), relate to E.U. law and are either difficult or impossible to complete for Third Country entities or in respect of Third Country assets.

[8] That due diligence is still required is further supported by the underlying policy objectives cited in the recitals to the EUSR which include: (i) the need to ensure that E.U. investors are subject to proportionate due diligence requirements (so that they can properly assess the risks and make an informed assessment on the creditworthiness of a given securitisation instrument); (ii) enhancing market transparency; and (iii) revitalising the European securitisation market.

[9] Although the ideal way to resolve the legal uncertainty set out in this letter would be a change to the level 1 text of the EUSR clarifying the point, the Committee understands that changes to level 1 text would be an impractical solution and hence any official guidance on the point would be very helpful. This could take the form of an update to ESMA's Q&A document on the EUSR, if not the form of a legally binding technical standard.

[10] This need not amount to an exercise as detailed as the disclosure annexes appended to the RTS.

[11] *Supra*, endnote 2.

[12] *Supra*, endnote 7. The FMLC understands from market experts that Third Country entities are typically not set up to make all the disclosures contemplated by Article 7 and in particular to comply comprehensively with fields in the templates specified under the RTS as Third Country entities typically do not have systems that integrate E.U. standards (given these standards do not apply to them) so as to be able to record data that complies with such E.U. standards and to then be able to report that data as required by the form of the templates specified under the RTS.

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

The FMLC is grateful to the FMLC's Securitisation Regulation Working Group and particularly to Joy Amis of Herbert Smith Freehills LLP, Andrew Bryan of Clifford Chance LLP, George Gooderham of Linklaters LLP, James Perry of Ashurst LLP and Sean Renfer of Sidley Austin LLP, for their contributions to, and comments on, earlier drafts of this letter.