Chambers
AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Securitisation 2023

Definitive global law guides offering comparative analysis from top-ranked lawyers

UK: Trends & Developments

Dimitrios Logizidis, Alexander Tompkins and Rosalie Johnstone
Gide Loyrette Nouel LLP

practiceguides.chambers.com

Trends and Developments

Contributed by:
Dimitrios Logizidis, Alexander Tompkins and Rosalie Johnstone
Gide Loyrette Nouel LLP **see p.8**

The UK Securitisation Regulations 2023 – UK Regulatory Divergence, Deregulation and Trade Receivables Securitisation

Equivalence abandoned

Considered by some as the start of the City of London's "Big Bang 2.0", on 9 December 2022 Chancellor Jeremy Hunt set out initial proposals to "review, repeal and replace" legislation in up to 30 areas of EU-derived regulation. The "Edinburgh Reforms" were announced as a step forward in the UK government's desire to "drive growth and competitiveness in the financial services sector" in the UK. One of the 30 announced areas was the UK's securitisation legislation, derived from European Regulation (EU) 2017/2402 and its associated regulatory technical standards and implementing legislation (the "EU Securitisation Regulation").

Following the UK's exit from the European Union ("Brexit"), many had hoped that the European Commission would adopt a decision granting equivalence status to the UK's securitisation regime implemented under legislation including the European Union (Withdrawal) Act 2018 and the Securitisation (Amendment) (EU Exit) Regulations 2019/660 (the "UK Securitisation Regulations"). Equivalence would have enabled a degree of re-integration of the UK's securitisation regulatory regime into and alongside the EU Securitisation Regulation, despite Brexit.

The UK government had, for instance, passed legislation in late 2022 which was seen by some commentators as evidence of the UK government seeking to maintain links between the regulatory regimes in pursuit of equivalence. The Financial Services (Miscellaneous Amendments) (EU Exit) Regulations 2022 provided that the UK's recognition of securitisations which obtain the simple, transparent and standardised (STS) label under the EU Securitisation Regulation will continue until the end of 2024. Regardless of the subsequent movement away from equivalence, those regulations will allow UK-regulated institutional investors to continue to benefit from the regulatory capital treatment applicable to investments in STS-label securitisation positions.

In its October 2022 report *On the functioning of the Securitisation Regulation*, the European Commission assessed "the case for an STS equivalence regime". The results of this assessment were largely negative in the short term with the European Commission considering it to be "premature to introduce an STS equivalence regime at this time". The report did, logically, mention the UK as the third country with the closest regime but highlighted the differences between the two regimes, notably with respect to the EU recognition of on-balance sheet securitisations as STS label-compliant. The report did note however that the European Commission would continue to monitor developments in third countries and would reconsider in the future. Some commentators interpreted this as leaving the door open to a future reassessment if the UK government would choose to strongly align (and continually update) the UK Securitisation Regulations and associated legislation with the EU Securitisation Regulation.

The UK government has now made its decision clear in this regard and, pursuant to the Edinburgh Reforms, will move quickly in the opposite direction.

UK Securitisation Regulations 2023

The UK government has already started substantive work to implement the Edinburgh Reforms as they relate to securitisation, and a draft statutory instrument has been published in the form of the draft Securitisation Regulations 2023 (the "UK Securitisation Regulations 2023"). Certain of the Edinburgh Reforms announcements were made in areas in which it is not immediately clear what action the UK government will take; however, securitisation market commentators have been pleased to see the clear commitment by the UK government to prioritising securitisation in its reforms.

The amendments introduced at this stage in the UK Securitisation Regulations 2023 are fairly minor in terms of substantive divergence from the text of the EU Securitisation Regulation. In particular, they aim at allowing the UK regime to continue to operate once the Financial Services and Markets Bill is passed. The Financial Services and Markets Bill will operate to revoke and remove the EU Securitisation Regulation from its status under the domestic laws of the UK post-Brexit following the European Union (Withdrawal) Act 2018.

However, a very significant change is proposed in the UK Securitisation Regulations 2023 involving the placing of the securitisation regulatory regime under the purview of the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) (together the "UK Regulators"), as opposed to the current statutory basis. Currently, the implementation of the EU Securitisation Regulation in the UK including through the UK Securitisation Regulations and potential amendments thereto have been handled by central government, with formal statutory processes needing to be followed even for simple amendments. This will now completely shift with the placing of the securitisation regulatory regime into the rulebooks of the UK Regulators. Following the UK Securitisation Regulations 2023, it will be possible for the UK Regulators to adjust elements of the regulations and issue clarifications to the regulatory regime on an almost instant basis. More substantively, the addition or removal of new elements of the regulatory regime would be possible on an expedited basis compared to the current regime.

Investor due diligence requirements – UK to EU and EU to UK

Prior to the implementation of the Edinburgh Reforms and the entry into force of the UK Securitisation Regulations 2023, EU-regulated institutional investors are required to ensure that any securitisation in which they invest (in EU Securitisation Regulation language, "hold a securitisation position") meets the requirements of the EU Securitisation Regulation pursuant to Article 5 of the EU Securitisation Regulation. Similarly, UK-regulated institutional investors are required, pursuant to the same provision of the regulation and as transposed into the UK Securitisation Regulations, to ensure that any securitisation in which they hold a securitisation position meets the requirements of the UK Securitisation Regulations.

To date, the obligations placed on UK and EU institutional investors to comply with these due diligence requirements have not been particularly burdensome, given the very close alignment of the EU and UK regimes. For most securitisations, an EU-regulated institutional investor can straightforwardly illustrate the compliance of a securitisation issued under the UK Securitisation Regulations with the elements required under the EU Securitisation Regulation. Similarly, a UK-regulated institutional investor can straightforwardly illustrate the compliance of a securitisation issued under the EU Securitisation Regulation with the elements required under the UK Securitisation Regulations.

Even immediately following the implementation of the UK Securitisation Regulations 2023, this may not change significantly given that the two regimes will remain substantively the same until further changes are made.

However, in the event that the UK Regulators significantly change and/or deregulate securitisation under the UK regime:

- EU-regulated institutional investors would no longer be able to illustrate compliance with the EU Securitisation Regulation Article 5 investor due diligence requirements in the event that a securitisation met only these changed standards; and
- UK-regulated institutional investors could be subject to a new investor due diligence standard, which may make it easier for such investors to invest in securitisations issued in the UK and outside of the EU (such as in the United States) in the event that such securitisations would not meet the standards of the EU Securitisation Regulation.

What could the UK Regulators do to make the UK securitisation regime more attractive?

Since the coming into force of the original EU Securitisation Regulation in 2019 there have been many areas of the regulation which have been problematic in implementation and practice. Adjustments to these areas together with regulatory capital changes (primarily as described below in *Solvency II reform*) could, it is hoped, make the UK a more attractive regulatory environment for securitisation. Areas to be first considered by the UK Regulators could include:

- amendments to the text of the regulation, perhaps amending the types of transaction that are regulated or introducing lesser requirements for transactions involving certain asset classes;
- amendments to risk retention requirements;
- changes to reporting requirements including transaction-reporting templates;
- adjustments to STS criteria and potential introduction of asset class-specific STS criteria;
- relaxation or clarification on application of investor due diligence requirements in different scenarios, notably for UK institutional investors investing in non-UK issued securitisations; and
- amendments to the UK's regulatory capital regime under the UK's Solvency II regime (as outlined below) to stimulate investment by UK-regulated and supervised institutional investors.

It should be noted that the EU Securitisation Regulation is currently undergoing review and change at the EU level, including the review by ESMA of certain reporting templates utilised in regulated securitisations as part of an effort to stimulate securitisation issuance (following a reduction in securitisation issuance), which is perceived in part to result from the introduction of the EU Securitisation Regulation.

The extent to which the UK Regulators will consider EU-level changes or seek to replicate any such changes remains to be seen.

Solvency II reform
The first item on the wish lists of many industry participants for the UK's deregulatory direction for securitisation relates to the regulatory capital regime for insurers. Although this requires further statutory change to achieve, amendments to Solvency II indeed form part of a separate planned pillar of the Edinburgh Reforms. Under Directive 2009/138/EC on the taking-up and pursuit of the business of Insurance and Reinsurance (and associated implementing and supplementary legislation) ("Solvency II"), insurers' regulatory capital treatment for investments in, amongst other things, securitisations, is set out as part of the Solvency II Solvency Capital Requirements (SCR) regime.

Following Brexit, Solvency II and the SCR regime remained part of the domestic legislation of the United Kingdom, administered primarily by the PRA. Solvency II as it applies in the United Kingdom was subject to a large review in 2022, resulting in proposals which are now planned to be implemented in 2023 as part of the Edinburgh Reforms. These Solvency II reforms, which will result in a regime renamed "Solvency UK", are aimed at lightening certain capital retention requirements which the UK government hopes will free up capital to be invested by regulated insurers in government priorities such as infrastructure and energy investments, and also in securitisation.

With respect to securitisation specifically, the Solvency II SCR regime sets the regulatory capital treatment for regulated insurance firms for their securitisation investments. Currently, there is a certain (and favourable) capital treatment and charge for senior securitisation positions issued by securitisations which have obtained the STS label.

However, this treatment is not extended to non-STS senior securitisation positions and securitisation positions also held in STS-label securitisations which are subordinated in any way (such as mezzanine or subordinated securitisation positions). As many commentators have noted for years, the Solvency II SCR rules create a mismatch in regulatory capital treatment between other investments that can be made by Solvency II-regulated insurance companies using a less penal regulatory capital charge and investments that may be made by such undertakings in the context of securitisation.

Indeed, highlighting those differences, in February 2022, Risk Control published an evidence-based study commissioned by the Association for Financial Markets in Europe (the AFME) entitled *ABS and Covered Bond Risk and Solvency II Capital Charges* (the "Risk Control Report"). Put simply, the Risk Control Report analysed the risks of certain European asset-backed security (ABS) tranches and certain covered bonds across different seniorities and subordinations in order to analyse their risks and the regulatory capital treatment that should be applicable proportionate to such risks. The Risk Control Report concluded that "for both non-senior STS and for non-STS ABS, the capital charges implied by our analysis are substantially lower than those contained in the current Solvency II rules".

The Risk Control Report therefore recommended a change in the Solvency II regime to apply a lower regulatory capital treatment for investments by insurers in non-senior securitisation positions in securitisations which have achieved the STS label, and also for securitisation positions in securitisations which have not achieved the STS label.

An amendment to the Solvency II SCR rules for UK-regulated insurance companies could have a significant impact on liquidity and investor demand for securitisation in the UK and, depending on the way that amendments are eventually introduced, could equally lead to UK-regulated insurance companies being incentivised to invest in securitisation more broadly (not just in the UK).

What could reform mean for trade receivables securitisation?

Trade receivables securitisation has long occupied a hybrid status within the securitisation industry. Trade receivables securitisations have different features from more typical ABS securitisation positions, and are an important tool for corporate treasuries involving the sale of trade receivables typically by operating businesses.

Trade receivables securitisations in the UK and Europe are almost always private securitisations for the purposes of the relevant regulations, and often involve the sale of a homogenous pool of exposures that are typically short-dated, especially when compared to other exposures commonly utilised in securitisation, such as long-dated mortgage secured loans. Trade receivables securitisation transactions often involve multiple sellers, across multiple jurisdictions and transactions, and often involve a high level of due diligence at the outset of the transaction.

Losses in trade receivables securitisation transactions are often minor and lower than losses historically suffered in other forms of securitisation. Finally, certain transactions involving trade receivables which are currently captured in the definition of “securitisation” may be structured in different ways (without any special purpose vehicle, for instance) that are not always expressly foreseen by the current regulations.

As a result, there is an argument for a different regulatory treatment for trade receivables securitisation, and the following areas could be particularly ripe for reform.

The definition of “securitisation” and range of transactions included within the scope of the EU Securitisation Regulation (and by extension the UK Securitisation Regulations) is very wide. The text of the UK Securitisation Regulations could be amended to remove certain transactions from scope, or to clarify how certain transactions can satisfy the regulatory requirements where such transactions are currently within scope of the regulations but do not meet the traditional concept of securitisation, for instance through the following.

- Clarifying the treatment of transactions that do involve tranching of credit risk but that do not involve any special purpose vehicle, including from an STS label perspective.
- Clarifying or removing certain requirements that do not apply to trade receivables such as the credit granting criteria implemented under Article 9 of the EU Securitisation Regulation. This was in some ways clarified through the insertion of Recital (14) in the EU Securitisation Regulation to seek to clarify that these elements of the EU Securitisation Regulation should not apply to trade receivables securitisation. Nevertheless, this non-application created certain issues of interpretation throughout the regulation that could be greatly improved.
- Removing certain reporting requirements for trade receivables securitisation or, at the least, amending reporting templates which have been published over time by ESMA as they relate to trade receivables.

In this regard, it should be recalled that ESMA published certain reporting templates to apply on a mandatory basis to all asset classes. It was initially difficult for market participants to apply these reporting templates to trade receivables securitisation, given the lack of a trade-receivables-specific template. Eventually, a regulator Q&A response clarified that the esoteric asset template should be used by market participants to satisfy the reporting requirements for trade receivables securitisation, and the market has since become comfortable with this approach.

However, arrangers, investors and originators have consistently commented that the design of the ESMA reporting templates and the information fields included therein results in burdensome information being required from originators, which is repetitive and of limited use to investors. It has been accepted that reform in this area is required. Trade receivables securitisation often involves detailed due diligence of the underlying receivables prior to entry into the transaction, which further reduces the justification for the same treatment in terms of reporting required for other asset classes.

- Removing certain STS label requirements for securitisation-utilising trade receivables, or amending criteria to exempt trade receivables from certain articles or to clarify how they should apply to trade receivables securitisation. Trade receivables securitisations utilising the STS label currently need to rely on interpretation of certain provisions of the EU Securitisation Regulation (and the UK Securitisation Regulations) to qualify for the STS treatment.

Conclusion

The transformation of the regulatory regime for securitisation in the UK from a statutory regime led by central government to a more agile and potentially responsive regime administered by the UK Regulators is a significant moment.

Whilst it had been hoped that the UK and EU regimes could achieve a continued alignment that might lead to the European Commission granting an equivalence decision, this has now seemingly been abandoned by the UK government. The UK government has however introduced a deregulatory movement in order to ease the regulatory burden on securitisation, and stimulate securitisation issuance in the UK and investment in securitisation globally by UK-regulated and supervised institutional investors.

The EU Securitisation Regulation is also going through some more limited reforms, including on transaction reporting, and the UK Regulators should continue to follow EU developments to ensure that any useful changes are introduced at the UK level.

Trade receivables securitisation would be particularly affected by certain proposed or potential amendments to the UK Securitisation Regulations, and it is hoped that the issuance of, and investment in, trade receivables securitisation would be stimulated by the regulatory changes proposed by the UK government.

Gide Loyrette Nouel LLP was founded in Paris in 1920, and is one of the leading international law firms, with 11 offices worldwide. The firm was a pioneer in developing securitisation and secured instruments (covered bonds) once they first appeared in France over 30 years ago, and its lawyers played an active part in drafting laws and regulations in this area. Today, the firm's Securitisation and Asset-Backed Finance practice has its key arms in London and Paris, from where it advises on all related regulatory and clearing issues on a broad range of transactions, including structured credit, synthetic securitisation and collateral management, FX and strategic equity. The practice is exceptional in terms of the volume, size and variety of transactions structured and negotiated by it in the context of innovative structured programmes for credit and non-credit institutions. Its integrated team of securitisation partners and associates across London and Paris make Gide's Securitisation and Asset-Backed Finance practice one of the largest in Europe specialising in securitisation.

Authors

Dimitrios Logizidis is head of the Banking and Finance practice of Gide Loyrette Nouel's London office, and specialises in banking and structured finance. He advises FIs, PE funds and corporates on a wide range of asset-backed financing, securitisation, covered bonds and general corporate finance deals. Dimitrios has acted for arrangers, private equity funds and originators in major whole business and trade-receivable securitisation transactions involving amounts up to EUR4 billion. He has also advised on multi-jurisdictional ABCP conduit deals, including in emerging countries, where securitisation was used for the first time. He notably advised the arrangers on the Hertz and Fraikin whole business securitisations, and Europcar/Eurazeo and ALD Automotive/Société Générale on their whole business transactions.

Alexander Tompkins is a Solicitor of the Senior Courts of England and Wales and an associate within Gide Loyrette Nouel's Structured Finance and Securitisation team in London. He acts for financial institutions, commodities traders, fintech companies and a range of corporates on their securitisation, structured finance, receivables financings and trade finance transactions. He works on trade-receivables securitisation transactions and receivables financings across Europe and in North America, and complex end-to-end business trade financing and refinancing arrangements.

Rosalie Johnstone is an associate in Gide Loyrette Nouel's London Securitisation and Structured Finance team, and a part of Gide's Banking and Finance practice group. Rosalie acts for financial institutions and corporates in securitisation transactions, with a focus on the securitisation of trade receivables, as well as a broad range of multi-jurisdictional banking and project finance transactions.

Gide Loyrette Nouel LLP

125 Old Broad Street
London
EC2N 1AR
UK

Tel: +44 (0)20 7382 5500
Email: UK@gide.com
Web: www.gide.com

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com