

Securitisation Risk Retention Requirements

EU, US and Japan Compared

| QUESTION/TOPIC | EU RULE | US RULE | JAPANESE RULE (PROPOSED IN DEC. 2018) |
|---------------------------------------|--|--|--|
| What transactions are covered? | Securitisations as defined in Article 2(1) of the Securitisation Regulation. Note that the definition depends on tranching of credit risk of the exposure/pool of exposures, and includes “synthetic” securitisation where tranching credit risk transfer; also includes open market CLOs that are EU CLOs (in all cases) or US CLOs (when selling to EU institutional investors). | Asset-backed securities (ABS) as defined in the Securities Exchange Act of 1934. Generally, includes securities collateralized by any type of self-liquidating financial asset where payments on the security depend primarily on cash flows from the underlying assets. Does not include synthetic securitisations or open-market CLOs. | Securitisation transactions as defined in Japanese Financial Services Agency (JFSA) Notice No. 19, 2006. Generally, includes any transaction in which the credit risk associated with an underlying exposure/pool of exposures is tranching and all or a part of such tranching exposures is transferred to one or more third parties. The proposed rule does not include an express exemption for open-market CLOs. |
| Which parties are bound? | Institutional investors, originators, sponsors, original lenders and securitisation special purpose entities (“ SSPEs ”) (depending on the relevant provision). | Sponsor (i.e., a person who organizes and initiates a securitisation transaction by selling or transferring assets, either directly or indirectly, including through an affiliate, to the issuing entity) or, in some cases, originator. | Investors. |
| What categories of investors? | The term “institutional investors” comprises credit institutions and investment firms, insurance and reinsurance companies, institutions for occupational retirement provisions and investors and authorised entities appointed by them, alternative investment fund managers, undertakings for collective investment in transferable securities and their management companies. | Any kind, subject to jurisdiction of US federal securities laws, with limited exclusions for non-US originators. | Banks, bank holding companies, credit associations, credit cooperatives, labor banks, agricultural cooperatives, fisheries cooperatives, Norinchukin Bank, Shoko Chukin Bank and certain other financial institutions regulated by the JFSA. |

| QUESTION/TOPIC | EU RULE | US RULE | JAPANESE RULE (PROPOSED IN DEC. 2018) |
|---|---|---|--|
| Who must retain the net economic interest? | Originator, sponsor or original lender (as defined in the Securitisation Regulation). | Sponsor or generally a majority-owned affiliate, which includes an entity (other than the issuing entity) that, directly or indirectly, majority controls, is majority controlled by or is under common majority control with, such person. Majority control means ownership of more than 50 percent of the equity, or ownership of any other controlling financial interest, as determined under US GAAP. | Originator as defined in the JFSA Notice: <ul style="list-style-type: none"> a. an institution involved in the origination of underlying assets directly or indirectly; b. a sponsor of an ABCP conduit or other similar program that acquires exposures from third parties. |
| How much risk must be retained? | 5% of nominal value of tranches sold to investors (for vertical slice option) or 5% of nominal value of securitised exposures (for other retention options). | 5% of (generally) fair value of ABS interests (per US GAAP). | 5% of nominal value of securitised exposures (for vertical slice, first loss tranche and L-shaped interest options) or equivalent amount of credit risk. |
| What forms of retention are permitted? | Vertical slice – 5% of nominal value of each tranche; Originator's interest – 5% of nominal value of each of the securitised exposures (generally not permitted in US rules); Random selection equivalent to 5% of nominal value of securitised exposures, provided there are at least 100 potentially securitised exposures (not permitted in US rules); First loss tranche (and any other tranches if necessary) – 5% of nominal value of securitised exposures; First loss slice of each securitised exposure. | Eligible vertical interest (like EU vertical slice); Eligible horizontal interest (like EU first loss tranche); L-shaped interest (not permitted in EU rules); Other special provisions, e.g. ABCP full support liquidity (permitted in EU rules as vertical slice); transferor interest in revolving pool securitisations (such as credit card master trust) similar to originator's interest under EU rules. | Vertical slice – pro rata portion of each tranche; First loss tranche – all or part of the most junior tranche equal to or more than 5% of securitised exposures; L-shaped interest – if the most junior tranche is less than 5% of securitised exposures, all of the most junior tranche plus pro rata portion of more senior tranches; Other forms provided that credit risk borne by an originator is at least equal to above options. |
| Can retention be guarantee or unfunded commitment? | Only if either (a) retainer is a credit institution, or (b) commitment is fully cash collateralized. | No, not permitted, except in very limited conditions – eligible ABCP. | No relevant provision (may be clarified by the JFSA on their final rule). |

| QUESTION/TOPIC | EU RULE | US RULE | JAPANESE RULE (PROPOSED IN DEC. 2018) |
|--|---|---|--|
| For how long must risk be retained (without hedging or transfer)? | On an ongoing basis. For as long as the investor interests or other non-retained securitisation exposures remain outstanding. | Generally, the latest of (a) 67% reduction of securitised assets since closing, (b) 67% reduction of ABS principal since closing, and (c) two years after closing. | For as long as the investor interests remain outstanding. |
| What exemptions are available? | Limited exemptions – e.g., securitised assets fully guaranteed by government entities and certain index-based transactions. | Exemptions for certain asset classes meeting specified conditions, such as qualifying residential mortgages, reduced risk retention for FFELP student loans; limited exclusion for non-US transactions. | Limited exemptions – only if an investor can judge the underlying assets of a securitisation were not originated inappropriately based on (a) the originator’s involvement in underlying assets, (b) the quality of the underlying assets, and (c) other relevant circumstances. |
| Can the retained interest be hedged? | Only where this does not hedge the retainer against the credit risk of the retained securitisation positions or the retained exposures. Retained exposures may be used as collateral for secured funding purposes including sale or transfer of the retained net economic interest provided that there is no transfer of exposure to the credit risk. | Certain limited hedging activities are permitted; full-recourse financing of the retained piece also permitted. | Hedging and other activities substantially mitigating credit risk of the retained piece are not permitted because the originator is not considered to hold the retained piece for the purpose of the risk retention requirement. |
| What are penalties for non-compliance? | For credit institutions and investment firms, insurance and reinsurance companies, additional capital charges will apply to non-complying investments; for other regulated investors, required divestiture or other regulatory sanctions. Originators, sponsors, original lenders and SSPEs may potentially be subject to a broad range of administrative sanctions and remedial measures or even criminal sanctions. | Enforcement action for Exchange Act violation. | The capital charge will be three times higher than that otherwise applied to compliant securitisation exposures, subject to a risk weight cap of 1,250%. |
| From when is compliance required? | From 1 Jan. 2019. | Since 24 Dec. 2015 (for residential mortgage-backed securities) or 24 Dec. 2016 (for other ABS). | From 31 Mar. 2019. |

| QUESTION/TOPIC | EU RULE | US RULE | JAPANESE RULE (PROPOSED IN DEC. 2018) |
|---|---|---|---|
| To what extent are existing securitisations covered? | Securitisations entered into before 1 Jan. 2019 are grandfathered unless new securities are issued or new securitisation positions are created on or after that date. | Rules apply to new ABS issued on or after the effective date (including new issuance from existing programs). | Securitisation exposures acquired by an investor on or before 31 Mar. 2019 will not be subject to the higher capital charge with respect to that investor. However, securitisation exposures acquired by an investor after 31 Mar. 2019 are covered with respect to that investor, even if issued prior to that date. |