THE 2019 EU SECURITISATION REGULATIONS AND THE AUSTRALIAN RMBS MARKET

The EU's new regulations regarding investments in securitisation transactions came into effect on 1 January 2019. The securitsation partners at US law firm ***Mayer Brown*** *look at the impact of the new regime and, in particular, the likely consequences for issuers from Australia.*

Offshore issuers are still grappling with how any changes might pertain to their issuance given there is a significant grey area in the regulation's language. This has led Australian originators to adopt varying compliance approaches.

OVERVIEW OF REGULATORY REQUIREMENTS

The EU securitisation regulation – 2017/2402 of the European Parliament and of the European Council, dated 12 December 2017 – lays a general framework for securitisation and creates a specific framework for simple, transparent and standardised (STS) securitisation.

It amends directives 2009/65/EC, 2009/138/EC and 2011/61/EU and regulations (EC) 1060/2009 and (EU) 648/2012, and will henceforth be referred to as the "securitisation regulation". It has been applicable since 1 January 2019 to all securitisations as defined in the securitisation regulation entered into from that date and to previous securitisations to the extent that they are no longer grandfathered.

The securitisation regulation revises and consolidates previous rules relating to securitisations including those regarding risk retention, disclosure and credit granting. It also introduces a ban on resecuritisation. The securitisation regulation specifies criteria that transactions will need to satisfy if the parties want the deal to be designated as an STS securitisation.

As was the case with past phases of EU securitisation regulation, such as the capital requirements regulation (CRR), it is Mayer Brown's view that the securitisation regulation should not directly require compliance by Australian entities participating in securitisation transactions, except where they are subject to supervision on a consolidated basis with an EU regulated institution and they will be holding an exposure to a securitisation.

However, the securitisation regulation may indirectly result in Australian securitisation originators, sponsors and securitisation special-purpose entities (SSPEs), each as defined in the securitisation regulation, being required to provide additional disclosure to EU institutional investors for them to be able to invest in Australian securitisation transactions.

INVESTOR REQUIREMENTS

Article 5 of the securitisation regulation imposes initial and ongoing due-diligence requirements on EU institutional investors. This means these investors will need to comply with the due-diligence requirements of the securitisation regulation in order to invest in a securitisation transaction with an Australian originator or sponsor.

Prior to investing in a securitisation transaction, an EU institutional investor must carry out a due-diligence assessment that considers risk characteristics and material structural features. Such institutional investors must also verify compliance with credit-granting standards, EU risk-retention requirements and, where applicable, the transparency requirements provided in article 7 of the securitisation regulation.

After making an investment in a securitisation transaction, to meet continued reporting and testing requirements an EU institutional investor has an ongoing obligation to monitor the compliance and performance of the transaction pursuant to written procedures established by the investor.

CONSEQUENCES FOR AUSTRALIAN ISSUERS

EU institutional investors that invest in securitisation transactions with Australian entities were previously required to meet due-diligence assessment and monitoring standards under the CRR. Other than the reference to the transparency requirements in article 7, the securitisation regulation due-diligence requirements are substantially similar to, but not the same as, the CRR due-diligence requirements.

In recent years, many Australian entities have voluntarily undertaken limited compliance with the CRR to make their securities eligible for purchase by EU investors. These already provide disclosure regarding underwriting standards and risk retention that could be sufficient to allow an EU institutional investor to meet the related due-diligence requirements of the securitisation regulation.

Article 7 of the securitisation regulation establishes transparency requirements for originators, sponsors and SSPEs, requiring certain specified information and documentation to be provided to investors, supervisory authorities and, upon request, potential investors in a securitisation transaction.

Originators, sponsors and SSPEs must make available all the underlying documentation that is essential for understanding the transaction, together with an offering circular. For deals where there is no offering circular, a transaction summary must be provided.

Issuing entities are also required to report certain significant events and to meet ongoing regular-reporting requirements. These require that certain asset-level information regarding the assets underlying a securitisation transaction be provided on specified reporting templates, to be established pursuant to technical standards.

There is some overlap between the general information required by article 7 and the information required by regulation AB for US Securities and Exchange Commission publicly registered transactions. This is also sometimes included in offering memoranda for unregistered Australian capital-markets deals. However, the provision of the asset-level information specified in the European reporting templates is beyond the scope of regulation AB.

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Providing this additional data is potentially costly and burdensome for Australian entities. As a result, the question of whether an EU institutional investor needs to verify that an Australian originator, sponsor or SSPE has made available the information required by article 7 before investing in a securitisation exposure is one of the most important interpretive issues raised by the securitisation regulation for Australian originators.

"Some EU investors may determine that the requirement to verify compliance with the transparency requirements under article 7, including the provision of asset-level data in the form of the required reporting templates, is applicable with respect to Australian originators, sponsors and SSPEs."

APPLICABILITY ANALYSIS

While the jurisdictional scope of article 7 is not specified, it seems likely that originators, sponsors and SSPEs that are not established in an EU member state generally should not be directly subject to the transparency requirements of the securitisation regulation.

This conclusion is supported by certain provisions of the securitisation regulation and other principles of interpretation. Furthermore, related EU regulations like the CRR have similarly been interpreted as not imposing direct obligations on non-EU entities.

Article 1(2) of the securitisation regulation indicates that it applies to institutional investors, originators, sponsors, original lenders and SSPEs. However, the securitisation regulation does not explicitly state that it only applies to such parties if they are established in the EU.

In certain provisions of the securitisation regulation a distinction is drawn between an originator, an original lender or a sponsor "established in the [EU]" and one "established in a third country". For example, the due-diligence verification requirements in article 5(1) of the securitisation regulation with respect to credit-granting and risk retention provide one verification standard if the relevant entity is "established in the [EU]" and a comparable but separate verification standard if the relevant entity is "established in a third country".

Consequently, it is clear that an EU institutional investor must verify compliance with the applicable credit-granting and risk-retention requirements. However, the section of the article 5 investor due-diligence rules requiring that the institutional investor verify compliance with the transparency requirements of article 7 is not drafted in the same way.

The phrase "where applicable" suggests that the requirement to verify compliance with the article 7 requirements is not applicable in all instances. One interpretation of this language would allow EU institutional investors to conclude that the requirement to verify compliance with certain elements of the transparency requirements, including the potentially burdensome asset-level data requirements, is not applicable with respect to Australian originators, sponsors or SSPEs because the securitisation regulation does not directly apply to non-EU entities.

If the market adopts this interpretation, it is unlikely the securitisation regulation will result in a significant increase in the amount of information requested from Australian entities by EU institutional investors. However, we are aware of different views on this point and some investors have taken

the view that they will need full compliance with the article 7 requirements.

EU institutional investors should make their own assessments regarding their compliance with the due-diligence requirements under the securitisation regulation. Some EU investors may determine that the requirement to verify compliance with the transparency requirements under article 7, including the provision of asset-level data in the form of the required reporting templates, is applicable with respect to Australian originators, sponsors and SSPEs.

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OFFSHORE APPROACHES

Thus far, Australian market issuers are taking varying approaches to comply with the securitisation regulation. This is somewhat like the approaches taken in the US securitisation markets. The three main approaches with respect to transactions with EU investors are:

1. Maintain the status quo and not make any additional changes for the securitisation regulation compared with previous market practice.
2. Take commercially reasonable steps to provide some additional disclosure.
3. Comply with the securitisation regulation as if the Australian originator were a European entity.

The first approach, where the originator does not make any additional changes for the securitisation regulation compared with the previous regime, relies on processes that are already used for regulatory compliance being sufficient to meet the new EU standards.

Transactions that comply with regulation AB or use regulation AB as a guide for the framework of the offering circular, which is the approach of most Australian RMBS issuers into the US market, may also meet some of the securitisation regulation's requirements.

Many of the disclosure requirements, other than those pertaining to article 7, overlap. Therefore, it is possible to achieve compliance with both the US and EU risk-retention requirements. For example, most Australian residential mortgage-backed securities transactions use the eligible vertical-interest retention and vertical-slice method, which complies with US and EU risk-retention regulatory regimes.

A second approach used in the Australian and US markets is to take commercially reasonable steps to provide additional disclosure. The originator of the securitisation, with its internal and external legal counsel, will determine the extent to which additional information can be provided, with advice from the dealers and their respective internal and external legal counsel.

Typically, the relevant decisions are made from a marketing standpoint as well as based on what the originator can reasonably do to comply. This tends to result in relatively bespoke solutions for each transaction and originator.

Nonetheless, common examples of this approach usually involve the undertaking of certain reporting requirements or modified compliance with the asset-level data templates. This can include further reporting around the data fields provided and the timing for compliance.

The third approach to the securitisation regulations is fully to comply as if the originator were an EU entity rather than an entity "established in a third country", including completion of the required reporting templates.

While many in the market do not think this approach to compliance should be required under the securitisation regulation, some market participants choose to undertake it in order to ease the marketing process of a transaction. This approach obviously maximises an Australian originator's EU investor base and is most appropriate if selling the transaction into the EU is important.

While the securitisation regulation became effective on 1 January 2019, the reporting templates have not yet been finalised. They have recently been adopted by the European Commission and we expect them to be adopted by the European Parliament and the Council of the EU in early 2020.

The market's approach to compliance will likely continue to evolve. But we anticipate that the approach taken by non-EU originators will become more established once the final templates for asset-level data are adopted. Regardless, Australian originators should continue to consult with both internal and external legal counsel while considering investor demands weighed against the burden of compliance with the EU regulations. ■

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